

A Beginner's Guide To Economics and Investing

Learn, Take Action and Make Change

Bartering

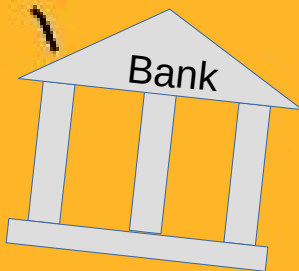
Money

Supply and
Demand



Currency

The Free Markets



Bank

Weimar
Hyperinflation



Investing

Justin Kelley

North



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Foreword

by Craig Lang

Having known Justin since he started high school it was of no surprise to me that he wanted to put pen to paper. Many students express such a desire. Not many have expressed the want to write a book on Economics yet it was equally no shock to me that when Justin told me he was writing a book – Economics was the focus. I use the word focus as Justin has always had the ability to do just that. When interested in a topic he is the literal “dog with a bone”. Many teenagers are like this. Where as most are focussed in pop culture and the like it is facts that interest Justin, with the complexity of the Economy being his topic of choice.

As his Commerce teacher it was clear that Justin not only had an interest but also an affinity for Economics. He loved the complexity, the miniature. He was learning to combine his love of detail with a developing analytical brain. Analysis is all through this book. He enjoys forming an argument and has a sense of assurance that comes from being young. You may or may not agree with the book’s assertions. Do enjoy the analysis behind them. Few teenagers care enough to think about these issues, fewer would write about them and in my years of teaching only one has written about them in depth with the level of analysis you will read here.

So I urge you to engage, as Justin has. I have no doubt he would enjoy the debate if you disagree with his conclusions.

As an educator I rejoice that he has come to them.

- Craig Lang

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Introduction

To the average person economics is something that seems to be too complex to understand. The elaborate way economists use terms like banking, investing, derivatives, monetary history and GDP convince people that economics is something that they will not understand. Yet these economists use this fancy way of talking about economics to show off and you will be surprised how simple economics is. The bare essence of economics is the supply and demand of goods, services and money. This book will teach economics and investing without all the complex jargon. You might also feel deep down that there is something wrong with our world economy. Why is it harder to make a living today than a few decades ago. Well the people in charge of our economy didn't learn from history and are leading our economy to disaster. Yet a disaster for some, a golden opportunity for others. Read this book to make this your golden opportunity.

Economic Energy

Money is the life blood of the economy. It is used to store economic energy (term Mike Maloney uses), which is one's time and what one can achieve with that time (labour). Money is used to store and trade resources. Understanding economics is critical to know how the powers to be are using the world economy to take away your economic energy.

"Your true wealth is your time and freedom. Money is just a tool for your time. It's a container to store your economic energy until your ready to deploy it, but the whole world has been turned away from real money and has been fooled into using currency. A deceitful imposter that is silently stealing your two most valuable assets: your time and your freedom."

Mike Maloney – "Money vs Currency – Hidden Secrets of Money Ep 1 – Mike Maloney"

The Problem We Face Today

Our current monetary system (the way money works in the economy) is a finite system that is designed to fail. There has been too much tampering with it and since 1971 the entire world has been using fiat currency, which inherently loses its purchasing power over time. The crash happened in 2008 as the Financial Crisis, but it was decided that "kicking the can down the road" was the solution. We didn't recover from the Financial Crisis, it was delayed and made much worse and now the cracks are widening. The rich are prospering from this at the expense of the common people, who will be really hurt when the time comes. However we can prepare for this crash by investing into real assets to protect ourselves from any further loses. This graph shows the amount of wealth we as people have lost in the last century. The irony is that inflation picked up with the formation of the Federal Reserve, which was meant to create financial stability.



Source: Wikipedia

So What Can Be Done

As history shows, our world economy will have to crash eventually and one can position themselves in a way to protect themselves or to maybe even profit from this event. This can be done by getting educated and then investing into real assets like precious metals. The upcoming crash shouldn't be viewed as a grim event as there are few moments like this that allow for massive gains to be made. Understanding how all this stuff works is needed to avoid financial disaster. By sharing this information we can educate others and help them prepare too and if enough people know about it, we can stop the stealing of our economic energy and freedom. So what can be done? Step 1: Educate yourself, step 2: Take action and step 3: Spread the word.

You may think Communism/Socialism is the solution to this problem, but as an early warning it isn't the solution. Capitalism is simply better than Communism, which Germany during the Cold War clearly shows and furthermore Capitalism might not guarantee economic freedom, but is a necessity for it. You find some form of Capitalism in places with economic freedom. Today we have a mixed economy (Between Communism and Capitalism) that is swinging towards Communism and has poor economic policies attached to it. What we need is the mixed economy, but with the rights policies such as a smaller government, less bureaucracy (to reduce restrictions, compilations and paper work) and better economic policies including a simplified tax system. There are different types of Capitalism and we need a competitive one.

Has This Happened Before

The problems we face today happened so many times in the past. The greatest hits are the end of the Athenian Empire, the collapse of the Roman Empire, the collapse of the Spanish Empire and the Weimar Hyperinflation. The process each event goes through can be called the Seven Stages of Empire, which is a cycle Mike Maloney defined. It's amazing on how history repeats itself and people never learn from their mistakes and we can now see how this currency crisis will take place using history.

What this Book Will Cover

This book will cover what money is, monetary history and on how this crisis will unfold and how it will happen. The book will also look at recent news, different areas of economics like banking and on how to prepare for the upcoming crisis. "*A Beginner's Guide To Economics and Investing*" purpose is also to help one peer through the "smoke and mirrors" of economics.

Money

Money is something everyone has heard of and wants. It is the life blood that drives an economy. Money is used in everyday living to buy products, pay bills and so on and everyone tries to obtain more of it. It is used to buy our wants and needs and has come in many forms throughout history such as coins, notes and strange objects. But, what is money? Money has many different names such as cash, bucks, dough and currency. Money is also often said to corrupt, but it is needed for an economy to prosper. This chapter will look at monetary history, different characteristics of money and why the currency we use today is not truly money.

Defining Economics

Investopedia defines economics as *"A social science that studies how individuals, governments, firms and nations make choices on allocating scarce resources to satisfy their unlimited wants. Economics can generally be broken down into: macroeconomics, which concentrates on the behaviour of the aggregate economy; and microeconomics, which focuses on individual consumers."*² Complex right? Well this book will break economics down and after reading, economics will be very simple to understand.

The following bullet points are a way to simplify the definition of "economics":

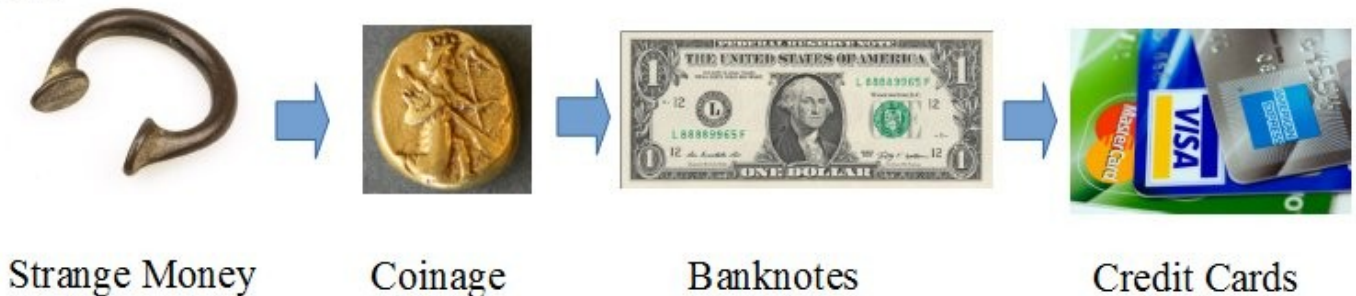
- Economics deals with the distribution of limited resources to satisfy the unlimited needs and wants of consumers.
- Economics centres around the concept of demand and supply.
- Macroeconomics is the economy as a whole and microeconomics is looking at the individual transactions with the economy.
- Money is the life blood of the economy and flows between different sectors of the economy.
- The Monetary system deals with how money is provided, the management of money and what form of money is used such as a fiat currency monetary system uses money backed by confidence.
- Money and other assets rise and decline in value.
- The issuers of money use their power to benefit themselves at the expense of others.
- Governments today can create money from nothing.

Moving forward, money and monetary policy will be covered first as they are essential in grasping economics.

What is Money?

The Collins dictionary defines money as the following: "*Money is the coins or banknotes that you use to buy something*"³, but this definition isn't very accurate. The true definition of money is much more than just banknotes and coins. Money has come in many different forms throughout history. Money first came in forms such as stone money or objects, then as random sizes of gold, silver and copper and then gold and silver coins. After coins, money turned into paper notes and now it's digital. The diagram below shows the transformation of money.

Tropenmuseum, part of the
National Museum of World
Cultures



However, each of these representations of money have different qualities and the problem is that not all of these qualify as money. The gold and silver coins are money, while the rest aren't and they are instead called currency. Money is used to store economic energy. The economic energy is the time and freedom one has. In the next few sections of this chapter, we will first look at the difference between money and currency and then the development of money from bartering.

Economic Energy

Economic energy is the time and freedom a person has. A person's economic energy can be seen as the work you can do within an amount of time and you are given money to store that value. The money is used to store the economic energy to be able to use it in the future. However currency loses the amount of economic energy it has and allows the issuers of currency to take away your economic energy.

Money vs Currency

The difference between money and currency is explained in Mike Maloney's *Money vs Currency episode* in his Hidden Secrets of Money series. The characteristics of money are as follows:

- **A medium of exchange:** This is something that can be used to buy goods and services.
- **A unit of account:** A base value of each unit, such as an ounce of gold all around the world that has the same price.
- **Durable:** The ability to last a long time period.
- **Portable:** Able to be moved around easily.
- **Fungible:** Each unit of currency or money has the same value, that is it is interchangeable. Mike Maloney explains this by saying, "*A Dollar in your pocket buys the same amount as a Dollar in my pocket.*"⁴
- **Divisible:** The ability to be divided.
- **Store of value:** The ability to store value.

Money has all these characteristics, while currency has all of these characteristics, except that it isn't a store of value. The reason why currency lacks this ability is explained below.

Money and Currency

Many people, even bankers, don't know the difference between money and currency and this lack of knowledge is one of the reasons why our economy is in a mess, because we use currency. If we used money then this wouldn't happen. Money and currency are a medium of exchange, unit of account, durable, divisible, portable and fungible, but only money is a store of value. A currency like the German Marks from the Weimar Republic is as useless as paper, while money like a gold coin from ancient Greece still has its original value or even more. Currency can't store value, money can and this is because money is backed by its intrinsic value.



Money



Currency

Intrinsic Value

The intrinsic value of an item is its natural value, the value of the materials it's made from. Money is backed by this value and so is very stable. Currencies however are backed by trust, which is a fiat value that can easily vanish. The intrinsic value of today's currencies are next to nothing as they are made from materials like paper and nickel. Even worse a fiat currency on computers have absolutely no intrinsic value. Gold and silver coins can have a fiat value on it such as a perineum value, but when that fails, the coin still has its intrinsic value to fall back on.

Purchasing Power

The purchasing power of money and currency is how much it can buy. For example, if an item costs \$20 US Dollars and \$35 Australian Dollars, the US Dollar then has more purchasing power as it can buy more than an Australian Dollar. Gold and silver are both suitable as legal tender as they don't lose their purchasing power due to inflation like paper notes and cheap metal coins do. Something retains its value by being scarce like gold, which is valuable because it's rare and that value would be lost if gold become more common. This is why money and currency lose their purchasing power when the amount of it increase. Gold and silver has to be mined out of the ground, while paper money can just be printed with any dominations of numbers on each note.

Why is this Important?

Our use of currency resulted in placing our economy into the current mess we observe and if we had used money instead we wouldn't be in this mess. The expansion of the currency supply is stealing your purchasing power and giving it to the rich and so you need to get your wealth into real assets to protect yourself from this scam.

"In the absence of the gold standard, there is no way to protect savings from confiscation through inflation. There is no safe store of value."

Alan Greenspan (American economist and former US Federal Reserve Chairman)

Inflation, Deflation and Value of Currency/Money

The often accepted definition of inflation is the rising of prices, but inflation is the expansion of the currency supply and prices rising is the effect of it. Deflation is the contraction of the currency supply. These also apply to other areas such as an economy deflating in size. Look at money as an asset, which can gain and lose value. The changing of values of different items causes a change of prices. The price of a loaf of bread for example can increase in price by the loss of the purchasing power of the money used to buy the bread, which is nothing more than the bread increasing in value against the money used. Simple supply and demand.

Fiat Currencies

A fiat currency is not backed by something of value like gold or silver, but is backed by confidence. This can be where a paper note comes from a printing press and the government through law makes the paper note legal tender, which ultimately gives the paper note its value. This is known as a fiat, which is a Latin word for an official decree. A fiat currency is completely based on confidence and if that fails, as happens time and again, the currency will lose all its value. When a government creates more currency and increases the currency supply, the purchasing power is diluted and decreases. The bad part of fiat currencies is that they are created from nothing.

"The modern banking process manufactures currency out of nothing. The process is perhaps the most astounding piece of slight hand that was ever invented...If you want to be slaves of the bankers, and pay the cost of your own slavery, then let the banks create currency".

Lord Josiah Stemp, Former Director of the Bank of England (1937)

Down to Zero

Every fiat currency ever made has gone back to zero throughout history. Either a fiat currency failed or sound money was debased into currency, which then failed. It's necessary to know that money can also be expanded, which is done through debasing. This is when a gold coin is mixed with copper to make more coins and so each coin has less intrinsic value and the money turns into currency. It's important to note that money can be debased into a currency and then inflated to zero. There are many cases of fiat currencies failing throughout history such as the Weimar Hyperinflation, Hyperinflation of the US Confederate Dollar, Hyperinflation of the Continental (American Currency during the Revolutionary War), Collapse of the Roman Empire, Collapse of the Athenian Empire and the Collapse of the Spanish Empire. This is now happening today. As soon as a fiat currency is introduced it starts losing its value. The US Dollar in 2012 has only 3% of its original purchasing power that it had when it was introduced and a 2013 \$1 US note would only be worth 5c in 1913. That \$50 note you have will buy you 2 silver coins and in a few decades only buy one and it will then go back to its intrinsic value of paper. Australian banknotes are the same as Monopoly money and all countries in the world are now using fiat currencies.

"At the end fiat money returns to its inner value—zero."

- Voltaire

This is a Zimbabwe Banknote during the Zimbabwe Hyperinflation (2008-09)



This is a Mark Banknote during the Weimar Hyperinflation in Germany



And don't think today, the fiat currencies won't go down to zero after each time in the past it has. The only difference in value of any paper banknotes are the value of the paper they are printed on.

Gold Standards aren't Full Proof

A monetary system can also be a gold standard, which is when the currency is backed by gold. This is better than a fiat currency, but it isn't money as it's the start of the scam and gold standards often lead to a fiat currency. This has happened in the last century. A monetary system using money would be using gold and silver or other valuables directly, but a gold standard still uses currency.

The US Dollar as a Gold Standard

During the 19th century, the US Dollar was on a gold standard and for every US dollar that was circulating there was an equal amount of gold in the US vaults. The government had in reserve the same value in gold to that of the total value of the currency supply. For example if \$100 was circulating there was then \$100 worth of gold in the vaults to back it up with. This restricted the government in print money and limit its ability to do things like deficit spending. This is why governments don't like using gold and silver because of its restraints.

A Closer Look

To look at it closer, imagine you have 1,000 gold coins and then you hand half of it in to a banker in exchange for a banknote, which is legally worth the 500 gold coins you hand it. So the banknote now has a value to it and can act as a claim check on that gold you put in. This is a gold standard. The banknote now has the value of 500 gold coins and it has the same purchasing power of it, but that purchasing power is based on trust. There originally was a value of 1,000 gold coins and now there is 1,500 gold coins worth in circulation. The bank created 500 gold coins worth of value, however the intrinsic value of that is still 1,000 gold coins and purchasing power for a single gold coin has gone down. This can lead to the fiat value of a gold coin failing below its intrinsic value. This is how a gold standard can expand the currency supply, however the real value is still the same. This happened with silver during the days of the Spanish Empire. Silver is money, but the Spanish decreased its value because of mining lots of it and due to poor money management. This will be explained in the next section of this chapter.

How the Scam Starts

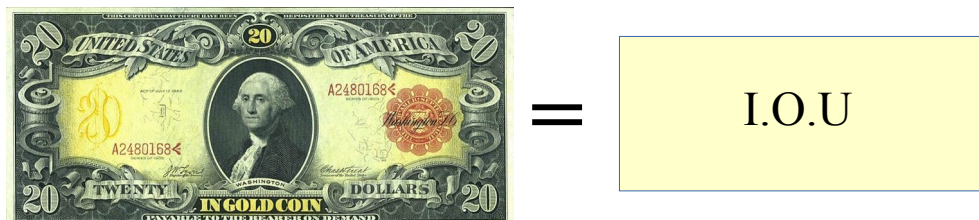
During the classical gold standard, every dollar was backed fully by gold and one has to add the value of the gold and the currency it is backing. Such as there being \$1 million in circulation and \$1 million worth of gold and that amounts to \$2 million. Through this system a government has created wealth out of thin air by doubling the amount of currency but by halving the amount of wealth. A gold standard might not be fully back one-to-one. During the Gold Exchange Standard, every dollar was only back by 40c of gold. A 40% reserve ratio and this allowed for the expansion of the currency supply even more. This quote below talks about how the general public does not know about this scam and if people knew about it, it would not be pretty. Today people are already getting upset about our corrupt monetary system.

"It is well enough that people of the nation do not understand our banking and monetary system, for if they did, I believe there would be a revolution before morning."

- Henry Ford (American industrialist and founder of the Ford Motor Company)

Currency as an IOU

The way a gold standard is a claim check system is that you can hand a \$20 note into a bank and get \$20 worth of gold in return. This makes the currency that is backed nothing more than a claim check. A promise to pay the holder of that check in the same amount of gold the check is valued at. Nothing more than an I.O.U.



Money can also Lose Value

Money can also become victim to value loss too, but at a much lower rate and it's much less likely. This is actually money turning into currency as an asset only remains money when it meets the right criteria. If silver become abundant it wouldn't be money any more, but gold and silver are just too short in supply to become currency. Before the discovery of the New World (Americas) silver was rare in Europe, but the Spanish brought back so much silver from the New World that it caused the value of silver to lower back in Europe.

The Spanish Empire and Silver

The Spanish would colonise most of the Americas, forging an empire, while becoming very rich. The first source of wealth came from sacking the treasures of the Inca and Aztec Empires. Gold was found, but silver also in far greater quantities. Francisco Pizarro González (Spanish conquistador who conquered the Incan Empire) would get 11 tonnes of gold and 22 tonnes in silver as a ransom for the Inca Emperor. After these initial sources were gone, Spain would find many sources of gold and mainly silver, especially in the Andes. 57,000 tonnes would be mined in 250 years, which lead to inflation of silver. The Spanish Empire would lose a lot of its wealth in wars, poor fiscal management and from piracy.

Spain used large quantities of its silver to buy goods from other European nations. These nations would obtain lots of silver. But, Spain was buying more then there was and prices rose while silver's value dropped. This resulted in the European Markets being saturated with silver no one really wanted. Spain in turn went into debt as they couldn't get enough silver imported from the New World to keep up with the demand. Prices were estimated to have risen by 400%. The silver crisis the Spanish caused would last for several centuries and the Spanish Empire would default several times before collapsing.

Debasement

Debasement is the ancient way of debasing money into currency. They produce more silver or gold coins by mixing more copper into the coins, which allows them to get more coins to spend with. However once the debasement is noticed then inflation kicks off. This isn't gold and silver losing value, but their coinage having less gold and silver in them and they turn into currency as a result of this.

Silver Inflation in Europe

London wheat prices in silver currency



The Dawn of Money

The invention of money happened many thousands of years ago in Lydia (Iron Age kingdom of western Asia Minor located in modern Turkey). Before the invention of money there was the bartering economy, which was limited. Money allowed an economy to become more complex and improved. It achieves this by making trading easier. The first forms of money were gold and silver. The invention of money supported the creation of the first great empires and also to the first great economic collapses.

From Bartering to Money

For many thousands of years before the invention of money, the world lived on a bartering economy. Bartering is the exchanging of goods between individuals. People didn't use any money, but exchanged goods for goods such as one cow for three chickens. The value of a product to another had to be established when trading. Bartering can also be used for services such as someone gives a person a cow in exchange for them doing something in return like building a house for them. This system was basic and made trading difficult and time consuming, which meant that the economies during that time were limited on how much they could grow. Bartering is even used today when money isn't around or not usable such as during economic turmoil or when making a trade between two people such as a phone for a Nintendo DS game console.

Around 5,000 years ago bartering changed into money in the form of gold and silver. However before that and after that currencies were invented in various forms and materials. Writings say that around 4,500 years ago in Ancient Mesopotamia silver was used to buy items in weighed amounts, which led to the creation of money. The Ancient Egyptians weighed precious metals to give them value. There are also strange forms of currencies used such as copper rings called manillas that were used in West Africa in the 15th century. In Santa Cruz, the natives there created their currency by having tiny red feathers glued together and attached to vegetable-fibre coils. The brighter feathers had more value. In Ethiopia, bars of salt were used as the medium of exchange. These are currencies as they lack creation properties that real money has.

Gold and Silver in Ancient Egypt

5,000 years ago gold and silver were first used as a medium of exchange in Ancient Egypt. Gold and silver were weighed using scales and then given a value. Value of items like rings, bars and lumps (See below) was based on weight and so trading was done with scales and prices were calculated in weight. The size or shape of gold, silver and copper pieces didn't matter. Their weight mattered. As each piece was different in size and weight they weren't interchangeable, which limited them to being a currency. To be interchangeable each unit needs to be same. At this point in time, as standard coins did not yet exist, items still did not have a standard price, making trade difficult. During transactions each chunk of gold or silver had to be weighed and have their purity guessed to determine their value to complete the transaction, whereby coins do not have this problem. Coinage is standardised by the mints that make them and governments also have a role in enforcing this standardisation.

Lydia and Greece: The Birth Place of Money

Currency first became money in 680-630BC in Lydia (today Turkey) when the first coins were invented. These coins were standardised and made from a mixture of gold and silver called electrum. This process of making coins is called minting and each coin had a stamp put on it to confirm its weight and value. Each coin had the same size and weight and so they were interchangeable (fungible). Each coin also was a unit of account and so became money. This way of organising money became successful and would soon spread over to Greece and then beyond. Money made trading easier and would rapidly expand in use in Athens. The Athenian Empire would flourish because of money, but the empire would become a shadow of its former self due to economic ruin, which is the first example of the Seven Stages of Empire.

Timeline Of Our Recent Monetary Systems

Years	Monetary System	Length	Description
1873-1914	Classical Gold Standard	30-40 years	Currency was backed by gold on a one-to-one basis, such as in the US handing in a \$20 note will give you \$20 worth of gold in exchange.
1914-1918	World War I Fiat Currencies	4 years	Currencies were taken off the gold standard to allow governments to print currency at will and do deficit spending to pay for the war.
1913-1944	Gold Exchange Standard	30 years	This was a gold standard, but not fully backed. It was only backed by 40% gold. A \$1 note is backed by 40c of gold.
1944-1971	Bretton Woods System	28 years	The US didn't get involved in both wars fully for a while and the European countries paid the US in gold for consumers goods such as cars and foods. After WWII, US had 2/3 of the world's vault gold and European almost none and many US dollar notes from loans and the monetary system wouldn't work. The new monetary system was made in 1944, where most currencies were backed by the US dollar, which was then backed by gold at \$35 per ounce. Each country was fixed and allowed trade to grow. No reserve ratio was set, so governments weren't restricted by how much currency they could print.
1971+	Dollar Standard	44 years+	Since the US wasn't restricted to how much currency they could print, the US could do a lot of deficit spending and printing on things such as the Korean and Vietnam War. The US currency supply expanded and loaned out to other countries. Soon other countries found out that the US didn't have enough gold to back up all their dollars and other countries started to ask for their gold back. The gold amount in the US dropped by half from 1959 to 1971. If the US lost all their gold then, the monetary system would collapse. There was 12 times more US dollars in 1971 than gold to back it. In 1971, Nixon took the world off the gold standard, stating it was only for a "temporary" amount of time, but we have been on the dollar standard since 1971. Each currency was now backed by the US dollar, which was backed by nothing. The world in its entirety was now a fiat monetary system.

Our world monetary system has changed every 30 to 40 years and our world's monetary system is on a fiat system and should change this decade or shortly after it. Every fiat currency ever made has failed and our world is now on a fiat currency. If a collapse now occurs, it will not be limited to one place, but it will affect the entire world! Governments will try to print themselves out of the crisis today as they have done almost every time in the past. Currently we are in the 6th to 7th stage of the Seven Stages of Empire.

Fundamentals of Economics

Having an understanding of economics is a necessity in today's world, as it plays such a big role in our lives and this understanding is also needed to avoid being financially devastated in an economic crash. Learning about money was the first step and the next step in obtaining a foundation in economics. This chapter will look at the fundamentals of economics in regards to the problems we have today, the different statistics used and the role of the IMF.

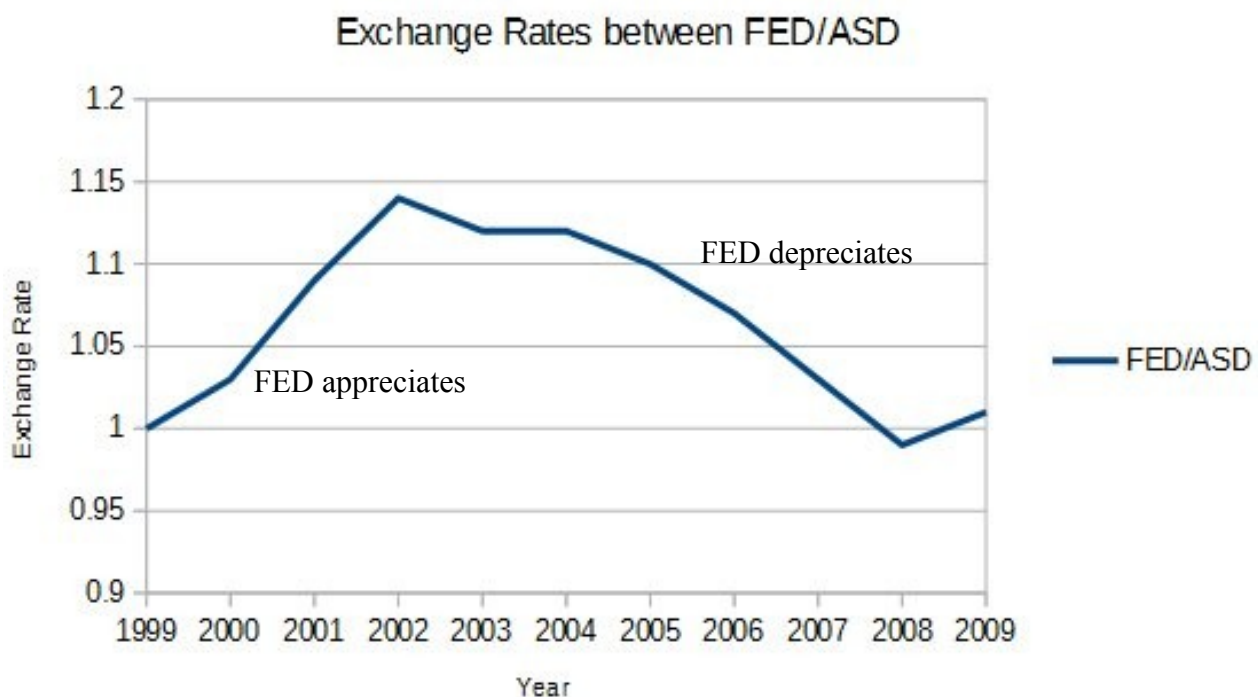
Basic Economic Terminology

Gross Domestic Product (GDP)

A country's GDP is the total value of the economy including consumption, investment, production of products and exports. The GDP displayed by statistics changes depending on the criteria the government uses. Today the governments are changing the criteria of what counts as GDP to make it seem better than what it is. Governments in some countries like in the EU include drugs and prostitution to make their GDP seem better than it is. GDP is even lower when inflation is included.

The Exchange Rates

These are the rates of exchange between the currencies around the world, which are often called the foreign exchange rates. These measure the value of one currency to another such as a rate of USD\$0.72 per AUD\$1, which means you can get 72 US cents for 1 Australian Dollar and USD\$1 for AUD\$1.39. When a currency such as the AUD increases against another like the USD, it is appreciating and when it loses value, the currency is depreciating. Below is a visual example of two fictional currencies.



List of Important Currencies

US Dollar: This is the current world reserve currency and currency of the US, most goods are traded in US Dollars, but countries are trying now to move away from the US Dollar.

Chinese Yuan: The current currency China uses and important as the possible currency to replace the US Dollar as the world reserve currency. China is also one of the strongest nations in the world.

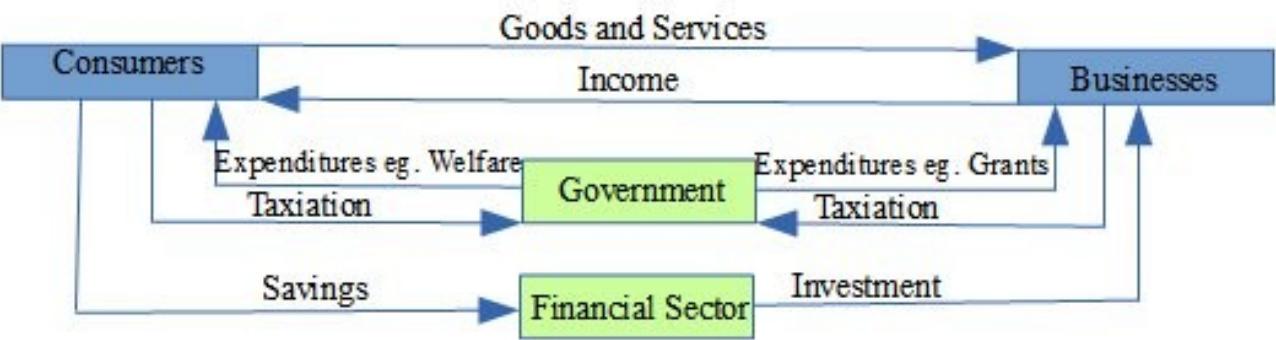
Euro: The currency used by the European Union. A widely used, strong and important currency.

Marco and Micro

Macroeconomics is looking at the economy at the whole, while microeconomics is looking at a much smaller area of the economy.

The Flow of Capital in an Economy

The economy is made up of a number of areas, which are linked together. A number of models have been made to show how an economy works and money is the life blood of the economy that flows between these sectors. Money also flows between asset classes with money going to an asset creating a bull and a bear occurring when money leaves that asset. This is a simple economic model showing the links between different sectors.

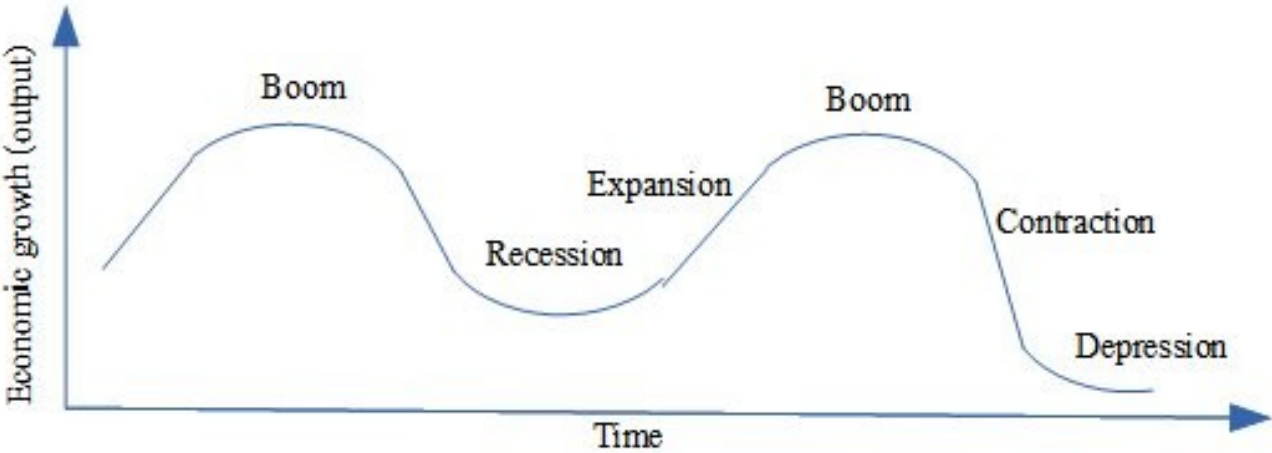


The Business Cycle

The business cycle is the booms and busts in an economy. The economy fluctuates between booms and busts from the change in economic activity. Below is a table that displays the characteristics of booms and busts.

Characteristic	Booms	Busts
Level of economic output	High	Low
Level of consumer spending	High	Low
Rate of inflation of prices	High (depends)	Low (depends)
Interest Rates	High	Low
Wages	Increases	Decreases
Unemployment	Low	High

The rate of inflation of prices can also be high during a bust that involves hyperinflation. Prices in booms tend to be high due to high demand and high circulation of capital (money), as supply can't meet that demand prices will rise. Below is a diagram of the business cycle.



Economic Growth

Economic growth leads to booms, which are a type of economic over-valuation and as a result, the economy will go into a downturn as a correction. An economy can't grow too fast and growth that is unjustified will result in a correction. An economy can grow rapidly if conditions allow it like during the Industrial Revolution as the growth was justified.

Supply and Demand

Supply and demand is one of the basic principle of economics. It decides the value of products and money and relates to many issues that have happened. An example is how the price of iron fell because an increase of supply diluted the market and so demand was lower then supply.



Rate of Circulation of Capital

This is the frequency money circulates in an economy. The frequency is how fast the total currency supply is circulating. Fast circulation increases prices and slow circulation decreases prices and therefore today with all this currency in existence a hyperinflation can occur if circulation picks up again.

Herd Philosophy

Human emotions drive the bulls and bears in the market. Emotions take hold on investors as everyone rushes in during bulls and flee during bears and it can be first one investor getting cold feet, but then the rest follow suit. This is how cows behave; if one gets scared then the rest will get scared too. This is what allows the economic booms and busts to be so big. You can't simply turn economics into a purely mathematical science as Long Term Capital Management demonstrated, as long as there are human factors at play. A large part of economics is about social science; what will the herd do and how will this effect society. Being financially smart is being aware of the herd-like behaviour of humans and not falling victim to it, but instead making informed rational decisions.

Important People

This is a list of important people that had or have a role in the economy.

Alan Greenspan: Former chairman of the US Federal Reserve from 1987 to 2006.

Ben Bernanke: Former chairman of the US Federal Reserve from 2006 to 2014.

Janet Yellen: Current chairman of the US Federal Reserve.

John Maynard Keynes: A famous economist that developed Keynesian Economics during the Great Depression, which is the idea that printing currency will get governments out of economic troubles.

Adam Smith: An 18th century economist that wrote the Wealth of Nations and has the idea the economy needs to be run by the free markets.

Richard Nixon: The US president that took the world off the gold standard onto the Dollar Standard in 1971.

The Stock Market

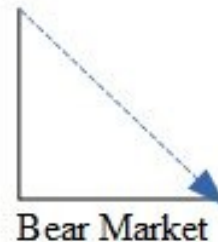
The stock market or share market is where companies sell shares of their company to investors in order to get more capital. The share market came about because companies needed more capital as they got bigger. A share is a part ownership of a company owned by a shareholder. A company's total value is the market cap and they issue a number of shares of their company's value. The share price is the market cap divided by the number of shares such as a company worth \$1,000 that has 100 shares has a share price of \$10. A shareholder gets a return in the form of a dividend, which is a percentage of the company's profits and a shareholder can also get a return if the share price appreciates. Stock markets around the world follow similar patterns due to globalization.

Price/Earnings (P/E) Ratios

This is a measurement used to determine if a stock of a company is overvalued (P/E ratio over 15), undervalued (P/E ratio below 10) or fair valued (P/E ratio is 10-15). It's the price of the stock of a company divided by its yearly earnings per share. The earnings per share is yearly earnings minus dividend payments divided by the number of shares.

Booms and Busts

Throughout history the stock market has gone into bubbles, which then have gone crushing down. People were taken by surprise each time with them losing a lot of their wealth and they never seem to learn from history. The booms and busts of this asset class also applies to the other asset classes. The larger the booms the greater the crash and a rise in a market is called a bull market and a drop in the market is called a bear market.



Risk and Current Situation

The stock market is naturally a very risky form of investment and a change in prices happen much faster today than in the past due to technology and high frequency trading. Globalisation also led to all the world's stock markets becoming connected. Currently, the stock market is losing real investors and it's being put up by the governments pumping currency into it to avoid a crash, but this intervention is making it worse and increasing the bubble size. This will be explained further in history and in wealth cycles.

Important Stock Market Indexes

Dow Jones: The average share price of the 30 largest companies in America.

NASDAQ: A stock market index composed from a number of American technology businesses companies.

S&P 500: The American stock market index composed from 500 different companies.

SSE Composite Index: The Chinese stock market index composed from Chinese companies on the Shanghai Stock Exchange.

S&P/ASX 200: The Australia stock market index composed from companies on the Australian Securities Exchange.

The Banking System

The banking system was first established in ancient Rome as a very basic system and for a long time was quite basic before developing into a very complex system in the 20th century. A bank is meant to loan people money and give interest back to people who put their money into the bank. However the deregulation of the financial system has allowed bankers to act in unethical ways to make huge profits. Many like the company Enron have been charged and fined for committing fraud over the last few decades.

The Reality

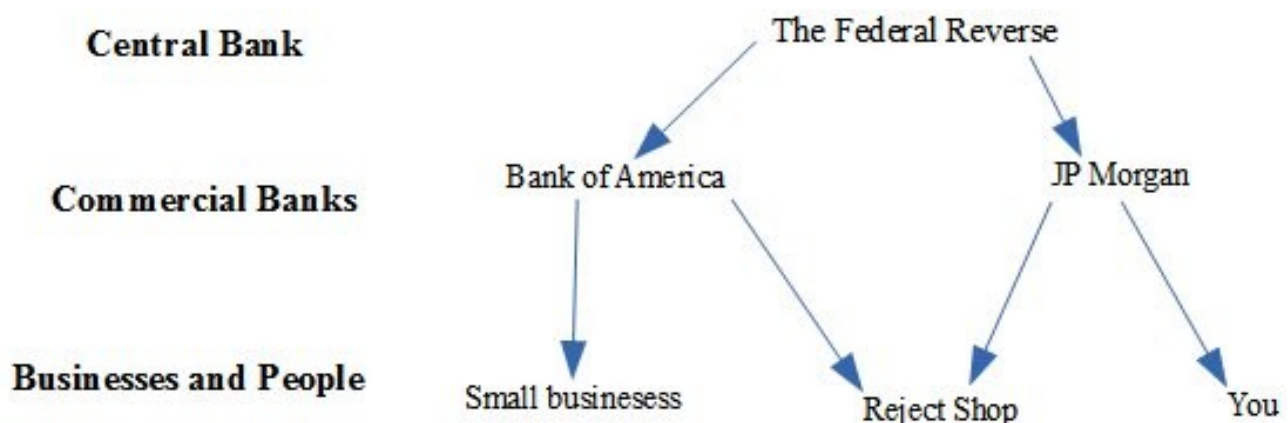
"I sincerely believe... that banking establishments are more dangerous than standing armies."

Thomas Jefferson

The banking system is one of the main reasons why our economy is in the situation it is in today. The bankers get involved with the debt system, the government and derivatives to make their profit. Since these bankers are very rich they have a lot of control over the government, who pass laws to benefit the rich and handicap the rest. The power the bankers have is enormous, which will become more evident as you read through this chapter.

The Banking Structure

At the top of the banking structure are the central banks, which lend money to commercial banks, which then loan that money out to businesses and people.



Central Banks

Central banks control the interest rates of the country, monitor the commercial banking system and they have a monopoly on the banking system. Each country has its own central banks, which control the nation's currency.

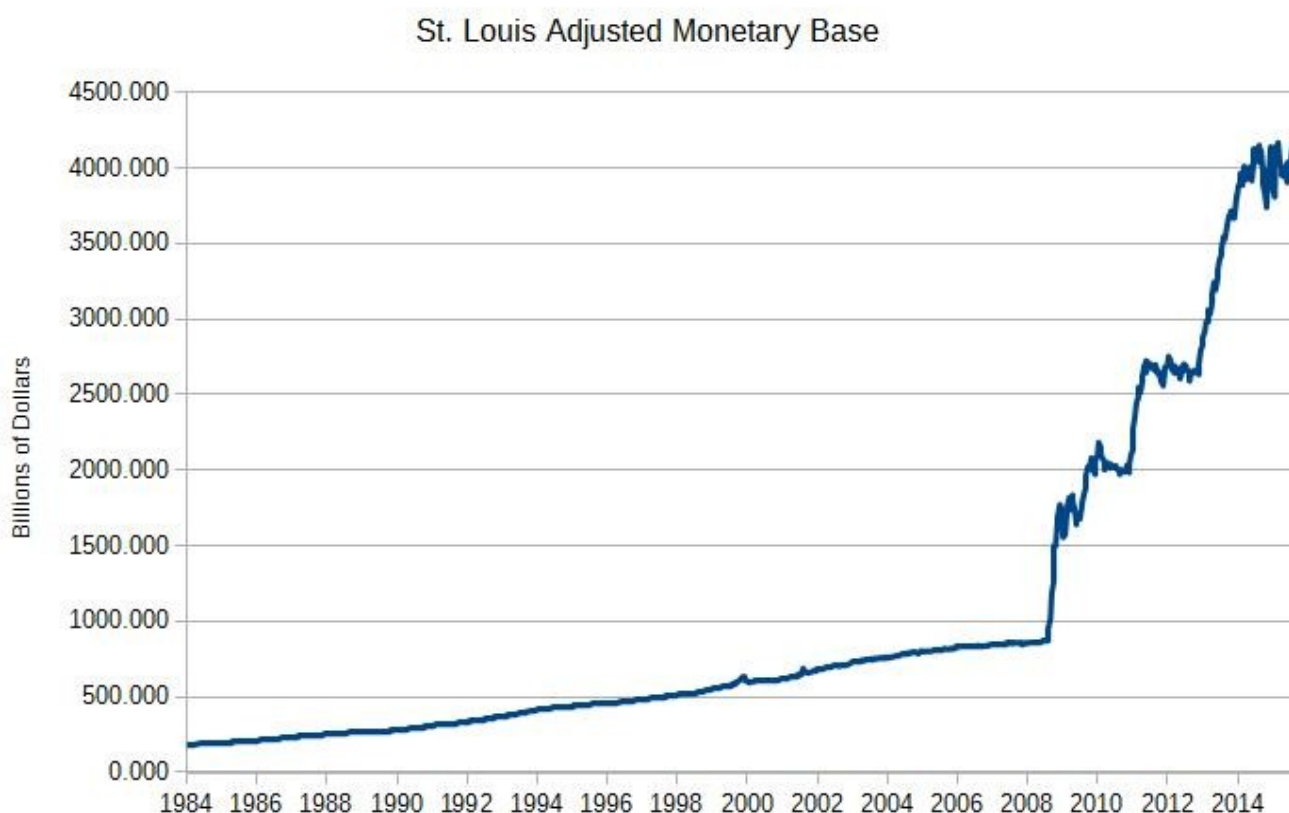
A central bank changes the interest rates (fed funds rates for USA) depending on economic conditions and interest rates have been very low or even zero right now. Low interest rates makes the flow of credit easier and this allows the central bank to lend currency out to commercial banks easier.

The central banks also are responsible for controlling the currency supply of the country. However this allows the central bank to commit a whole new level of fraud by being able to create currency from nothing and then spend it.

Even the inception of the US Federal Reserve involved fraud. The people that established the Fed were bankers that owned 25% of the world's wealth and one of them was a senator tasked with investigating the others for fraud. Yet the senator joined them in order to create the Fed. They brought the Aldrich Plan to Congress, but it was turned down and then they reorganised the plan and a second attempt to pass the plan in Congress was successfully. The reason why it was hard to pass the plan was because the people in Congress saw it as a scam.

A Helicopter Drop

Ben Bernanke, who was the chairman of the Fed (Federal Reserve) from 2006 to 2014, said in 2002 that *"the U.S. government has a technology, called a printing press (or, today, its electronic equivalent), that allows it to produce as many U.S. dollars as it wishes at essentially no cost."* and he also referred to Milton Friedman's famous statement about a "helicopter drop" of money to fight deflation in his speech.⁴ This is being done to fight off a deflationary collapse of the monetary system, particularly the contraction of credit and by printing currency, the Fed is generating inflation in order to fight off deflation. This goes in line with quantitative easing, the ability to pay off debt by printing and it also steals value from the middle and lower classes and gives it to the bankers. This basically gives the bankers infinite wealth, but its attempt to fix the economy doesn't work, as Japan has attempted and has been failing now for over two decades. All that printing does is increase the currency supply and lower the purchasing power of that currency. Below is the currency supply of the US. It took around 200 years to create 800 Billion US Dollars, but in less than a decade that amount has multiplied by 5 times. This massive increase is not normal.



Source: Federal Reserve Bank of St. Louis, St. Louis Adjusted Monetary Base [BASE], retrieved from FRED, Federal Reserve Bank of St. Louis <https://research.stlouisfed.org/fred2/series/BASE/>, November 28, 2015.

"The United States can pay any debt it has because we can always print money to do that."

Alan Greenspan

Our current monetary system is a debt based system that requires debt to be made for currency to be created and the printing press allows the US to pay back any debts it has at the expense of its people.

Hidden Inflation

With all this currency creation one might expect massive inflation, but most of this created currency is parked into places like banks and so causes the overall velocity to go down.

Commercial Banks

The commercial banks accept saving deposits from people and then they loan it back out. Commercial banks also get involved in many more areas to make profit, which most should be illegal. Commercial banks get involved in derivatives, which I explain shortly, and also gamble with the currency they get from their creditors, who are the people that put their currency into the banks as savings. These banks also take the mortgages and other debts they own and sell it to investors, but these become unbacked debts like other derivatives. Central banks also get involved in these unethical activities. Derivatives in this case are a repackaging of various types of debt, which attempt to minimise debt failure by the creditor and are on-sold to various investors.

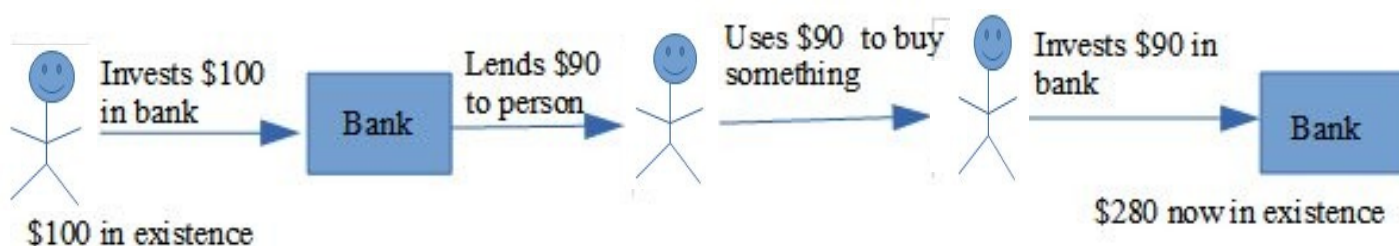
Fractional reserve Lending

Fractional reverse lending is one of the biggest ways currency is created and this is done by commercial banks. It's responsible for the creation of about 90% of all the currency in existence and the generic process is as follows: Firstly a person deposits \$100 in a bank savings account, and as the banks know that the people only use a small fraction of their savings at any one time, so the banks take part of that original \$100 to loan out to other people. This currency is also used by banks to gamble with.

The amount of money used by the bank depends on the reserve ratio and for this example, let's say it is a 10% ratio. This means the bank can use \$90 of the original \$100 to loan out to another person and they put an IOU of \$90 up for the person with the savings account. The other person uses that \$90 loan to buy something from someone else, who then uses that \$90 to put into their savings account and then the bank loans \$81 (because of reserve ratio of 10%) of that out to someone else and so the cycle repeats. This creates currency and can be visually seen below. Proof for fractional reserve lending is given by the Federal Reserve itself in the quote below.

"Commercial banks create checkbook money whenever they grant a loan, simply by adding new deposit dollars in accounts on their books in exchanging for a borrower's IOU."

Federal Reserve Bank of New York, "I Bet You Thought", Page 19



Bank Holidays, Bail-ins, Bail-outs and Capital Controls

Are methods by which those in power use to stop the failings of the banks and the banking system when economic problems occur. Because of fractional reserve lending, banks can quickly become insolvent either through bank runs, which is a big rush of people trying to get their saved money out of the banks, also the defaulting on loans, gambling failures or a collapse of an asset class can cause a bank to become insolvent. An insolvent bank or business can get bailed-out, which is where capital (currency) is given to them to solve their problems with. The currency often comes from the taxpayers or printed currency.

In a situation like this, a bank holiday is called, which stops or limits people from getting access to their currency in the banks. Capital controls are imposed and people are limited to how much currency they can get from the bank tellers or ATMs each day and often after short periods the banks are out of currency anyway, so the people can't get their currency back. Worse yet is a bail-in, which is where the bank takes a percentage of their creditors money, who are the people with savings accounts in that bank, to recapitalise the bank again.

Burdened by Debt

Countries are becoming more burdened by debt and so are forced to reduce government spending on things such as pensions and other social schemes. This is known as austerity measures and has recently taken place in Greece as part of the bail-out packages. Governments are not only burdened by their national debt, but also by their unfunded liabilities which are expenditures like welfare the government expects to pay in the future. US presidential candidate, Ben Carson in 2014 stated that the US had a total of \$211 trillion of unfunded liabilities.

Investing Money into Banks

Capital controls and bank holidays have happened in Cyprus and Greece in the recent past and should be a warning sign that putting your wealth into banks is a risk. Also, these savings accounts offer almost no return with the zero to negative interest rates, which then makes investing money into banks a bad idea.

How Our Debt System Works

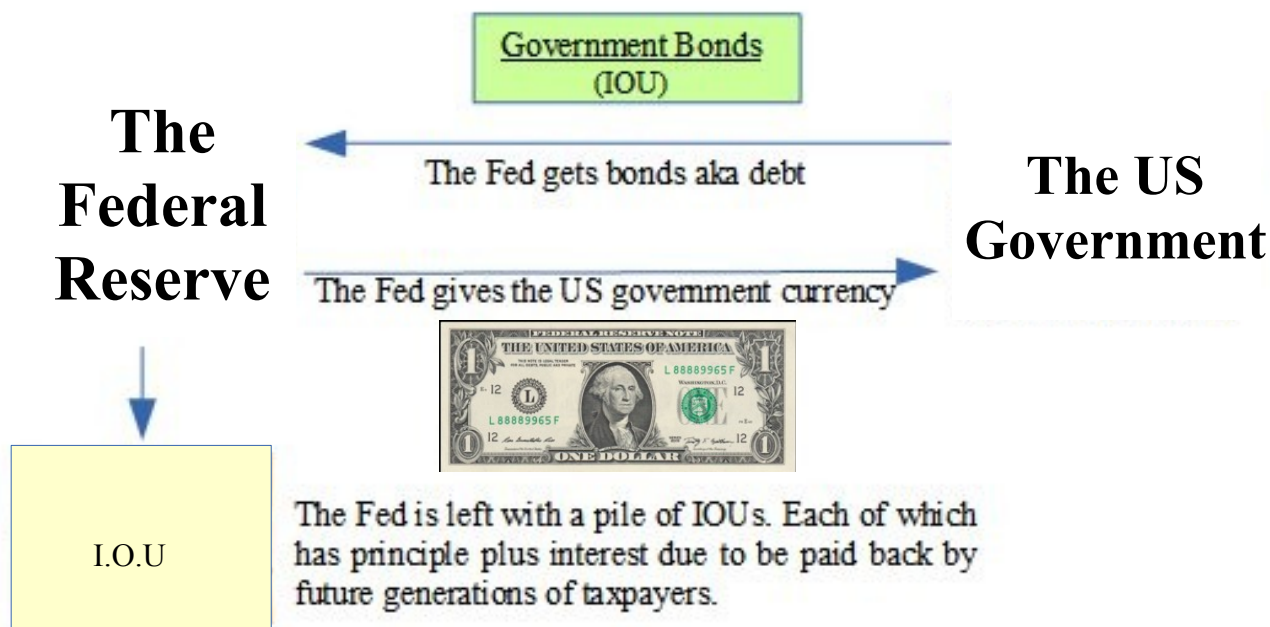
The way our debt-based monetary system works will now be explained. This system is why our world economy is in bad shape and it relates to many of the things explained above such as the problems with currencies. This system will be explained in seven steps. In general all national central banks go through the following steps, but for reference, the Federal Reserve Bank of the United States will be used in the following explanation. Watching Mike Maloney's Youtube video "The Biggest Scam In The History Of Mankind (Documentary) - Hidden Secrets of Money 4 | Mike Maloney" will help reinforce your knowledge of how this system works.

Step One

A nation has an election and the party that promises to spend the most money on various voter groups will usually win, but to pay for these extra expenditures the government has to do deficit spending. Governments mostly do deficit spending in wars, but today deficit spending is required to pay back debt and to pay for public works, social programs and welfare. Deficit spending is paid back in the future. We take away prosperity in the future to be able to live well now.

Step Two

This step is how the government funds its deficit spending through government bonds, which are basically IOUs. The government is given currency by an investor, who gets paid back the principle plus interest over a long time period like ten years. The government bonds are sold to investors, other countries or to the central bank, which is a separate entity from the government. The government sells these IOUs to big banks, who use open market operations to make a profit by selling these bonds to the Fed. The Fed however pays for these bonds by creating currency from nothing. This currency is then given to the banks, who will use it to buy more bonds from the government. The government then spends this currency and this cycle repeats resulting in a build up of government bonds at the Fed each of which has to be paid back.



"When you or I write a check there must be sufficient funds in our account to cover the check, but when the Federal Reserve writes a check there is no bank deposit on which that check is drawn. When the Federal Reserve writes a check, it is creating money."

"Putting it Simply", Boston Federal Reserve

Step Three

After the currency, which was created by the Federal Reserve and was spent by the government on various things, which is explained in step 1. People end up with this money and put it into their savings accounts and then fractional reserve lending occurs, which was explained in the previous section. Fractional reserve lending results in the creation of lots of bank credit as explained by the German Bundesbank, *"Money is primarily created through the extension of bank credit. The commercial banks can create money themselves."*⁵

Step Four

The processes in step two and three result in an ever increasing public debt and the expansion of the currency supply. This results, as explained in the chapter "Money", in an increase in the currency supply, which results in the decrease of the purchasing power of that currency. Our whole currency supply is created by fractional reserve lending and the Fed and the government swapping IOUs. We also work for this currency, which gives the currency its value through our confidence. We are then taxed and most of our taxes are not used on things like schools, but used to pay the principle and interest on that bond the Fed paid for with currency created from nothing. Another fact, is that income tax was never needed during peace time until the Fed was established. So this system resulted in high government expenditures that shouldn't be necessary.

Step Five

Another important fact is that when currency is created it is created through debt. This means that there is more debt than actual currency in existence and for each unit of debt paid off, a unit of currency is destroyed. So, to get more currency to pay that debt, we have to go further into debt or the system will collapse. The debt payments never stop. But, the increase in debt grows faster than the amount of currency created and the debt keeps increasing until the whole system implodes in on itself. This relates to the problem of debt celling. The governments have to keep rising the debt celling for an ever increasing debt for the system to work. This type of monetary system can't be maintained over longer periods. Those currently in power will continue this process as they don't want to be responsible for its demise. In summary, the idea of a balanced budget doesn't work and a debt based monetary system like we currently have doesn't work either.

Step Six

"Inflation is taxation without legislation"

Milton Friedman

The way this system works, is that it steals wealth from the poor and gives it to the rich through inflation as explained in the quote above. The rich get to spend their currency, which will have lost some of its value by the time the working class gets it. They also make profits by trading the debt between the Fed and the US Government and those who own a share of the Fed will earn even more via dividend payments. Therefore this system is designed to benefit those that issue money or currency.

"The decrease in purchasing power incurred by holders of money due to inflation, imparts gains to the issuers of money"

St. Louis Federal Reserve Bank (Review, Nov. 1975, p.22)

The Debt Crisis

The previous section discussed why our monetary doesn't work and it has led to a global debt crisis. Each country is in debt with the US, Japan, Europe and other select countries being very far in debt and the numbers most countries depict as their debt is much lower then it truly is.

A Mountain of Debt

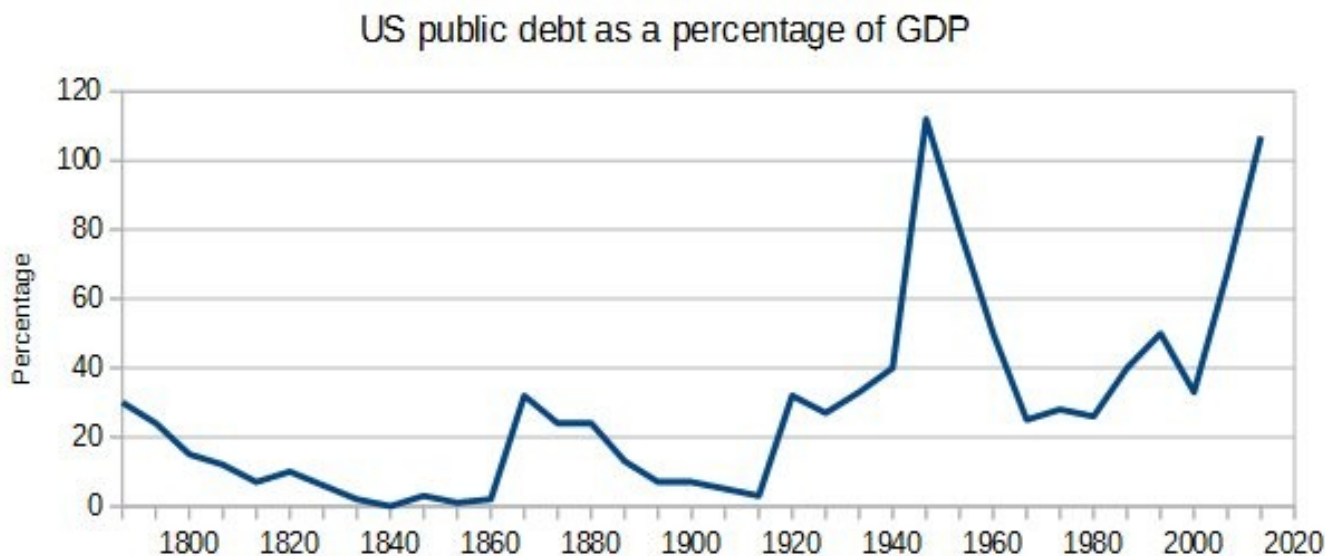
When looking at debt, the amount of debt is a good indicator, but the debt as percentage of GDP is more accurate. Debt to GDP shows how large the debt of a country is in comparison to the size of its economy and it is an easy way to compare debt levels of different countries. Normally a debt the size of a nation's GDP is unsustainable, but countries like Japan have debt twice the size of their economy. Below is a table showing the debt of different countries as of November 2015.

Country	Debt	Debt as percentage of GDP	Debt per Capita (person) in US Dollars
United States	US\$18.6 trillion	107%	\$58,000
Australia	AUD\$577 billion (US\$418 billion)	26%	\$17,700
Russia	16.4 trillion Russian Rubles (US\$248 billion)	12%	\$1,700
China	Chinese Yuan 34 trillion (US\$5.3 trillion)	65%	\$4,000
Greece	€404 billion (US\$427 billion)	180%	\$39,000
Germany	€2.1 trillion (US\$2.2 trillion)	70%	\$28,000
Japan	Japanese Yuan 1.25 quadrillion (US\$10 trillion)	201%	\$80,000

The above table shows how bad the debt crisis is. Most other countries are in a similar situation. Japan is currently in serious debt and their currency is highly inflated due to them trying to print their way out of their problems.

The US Debt Mountain

The graph below shows the massive amounts of debt the US is in. The US debt as a percentage of GDP is actually now as high as it was during World War II. Generally these levels come from war and so this is a real concern that this debt can't be paid off like in the past. The current debt levels are much higher than what is actually depicted by the various governments. But even these false levels of debt are astonishing.



Source: Congressional Budget Office

More Debt!

According to Marco trends the actual debt to GDP for the US is 330% if it is CPI adjusted. Yet Dr. Marc Faber says that the debt is much higher. He states that the debt to GDP was 186% during the Great Depression and that it's now over 800%! if you include unfunded liabilities. Even without adding them, the debt to GDP would still be 400%. These massive levels of debt are just not sustainable.

Is there any way out?

The obvious way to solve this debt problem would be to cut down government spending massively and remove the enormous US budget deficit of \$486 billion. However a large portion of government spending goes to welfare and social programs. The US people are very dependent on the government and a reduction in government expenditures would cause rioting and instead the government prints currency instead to pay for the deficits. Also, the way the monetary system is designed requires the government to keep going further and further into debt as explained in the previous section. The government is literally backed into a corner.

The way the Government does it

Not only does the government print currency, but they also increase taxes to solve this, but it doesn't. The US is facing a record high deficit and debt, despite record high tax revenues of US\$2.6 trillion. What they don't get is that increased taxes puts more burden on the economy and taxpayers and results in a worsening economy. The Roman Empire did the same thing and look where it got them. This is a common pattern that happens when things go bad and examples of it will be shown in the next chapter: History.

It's not just the US

This debt crisis the US faces is also experienced by other countries all over the world.

Quantitative Easing

Is a part of the system explained in the "How Our Debt System Works". The governments first print currency as explained in that section, but at a much faster rate causing a massive debt increase and currency supply expansion. This currency that was printed is then spent in different areas such as the stock market. Quantitative easing (QE) is meant to help the economy recover and is only a temporary solution, but governments have been using this for a long time now. QE gets used over and over again, but fails to recover the economy.

Quantitative Easing Currently

Quantitative easing is currently being used to pump currency into the stock market to artificially push it up, but manipulation can go only so far. As explained above, quantitative easing doesn't work as each time it stops, the stock market goes down and then they have to start QE again. This resulted in a massive increase in the currency supply and at the same time, the stock market lost real investment and started filling up with "garbage" investment. The stock market got to a point where the manipulation failed and it dropped on Black Monday in 2015. This printed currency has also been put into other areas such as public works and the bond market.

QE 1,2, 3, 4, 5...100

QE has failed over and over again and resulted in a rapid increase in currencies. Japan has tried it for 25 years and all that it achieved was to inflate their currency and stagnant their economy. This also happened in Europe, the US, China and all over the world, as each country uses different names for QE, but all of them are just printing currency. Each currency in the world is having its currency supply increased, which the US is doing at a much greater rate. However, as the US Dollar is the reserve currency of the world, its value stays propped up, as it is required for global trading.

The next graphs in the next section show the increasing currency supply of different currencies.

Currency Supply Measures

The following are different measures used to calculate the size of a currency supply. The more broader measures tend to be higher value and more long-term assets that are harder to liquidise (turn into cash and be used in transactions).

M0: This is the most liquid type of currency, like cash and assets that can be easily converted to cash.

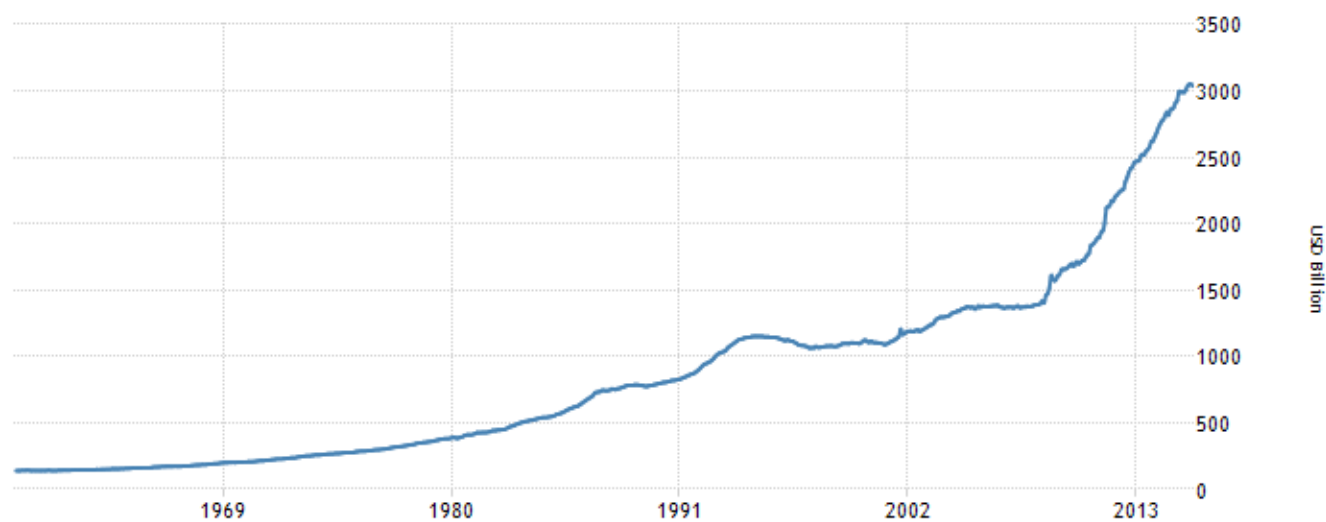
M1: This includes M0 and currency that can be easily converted to cash.

M2: Includes M1 and currency that is harder to liquidise like short-term deposits.

M3: Includes M2 and currency that is really hard to liquidise like long-term deposits. This is the most broadest measure used by most nations, but some nations like the United Kingdom use M4, which is the most broadest measure used.

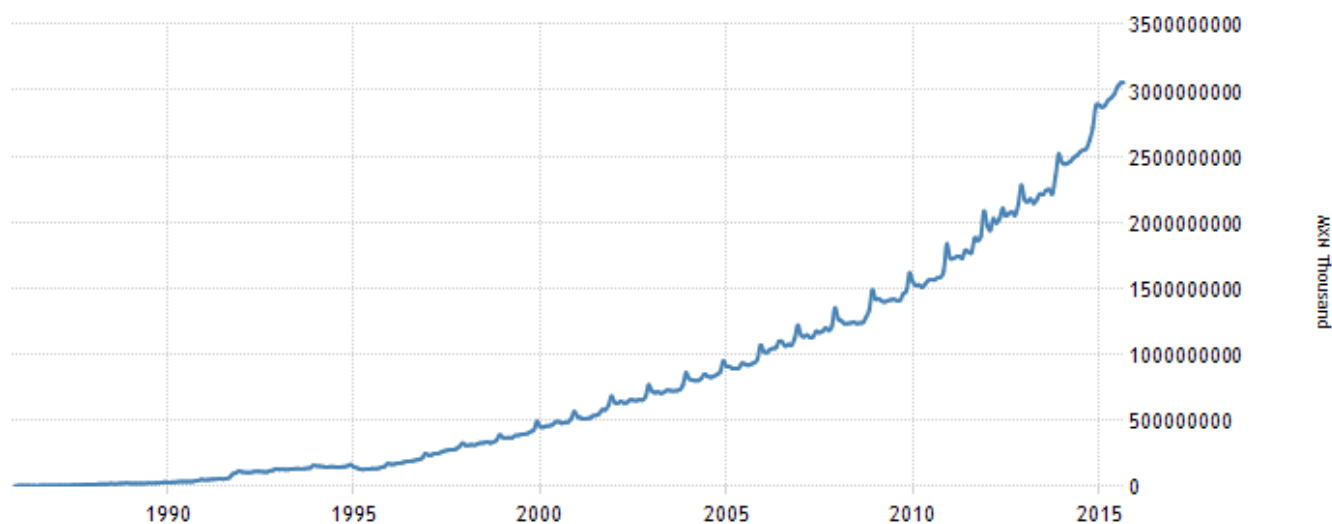
Graphs of Currency Supplies

US MONEY SUPPLY M1

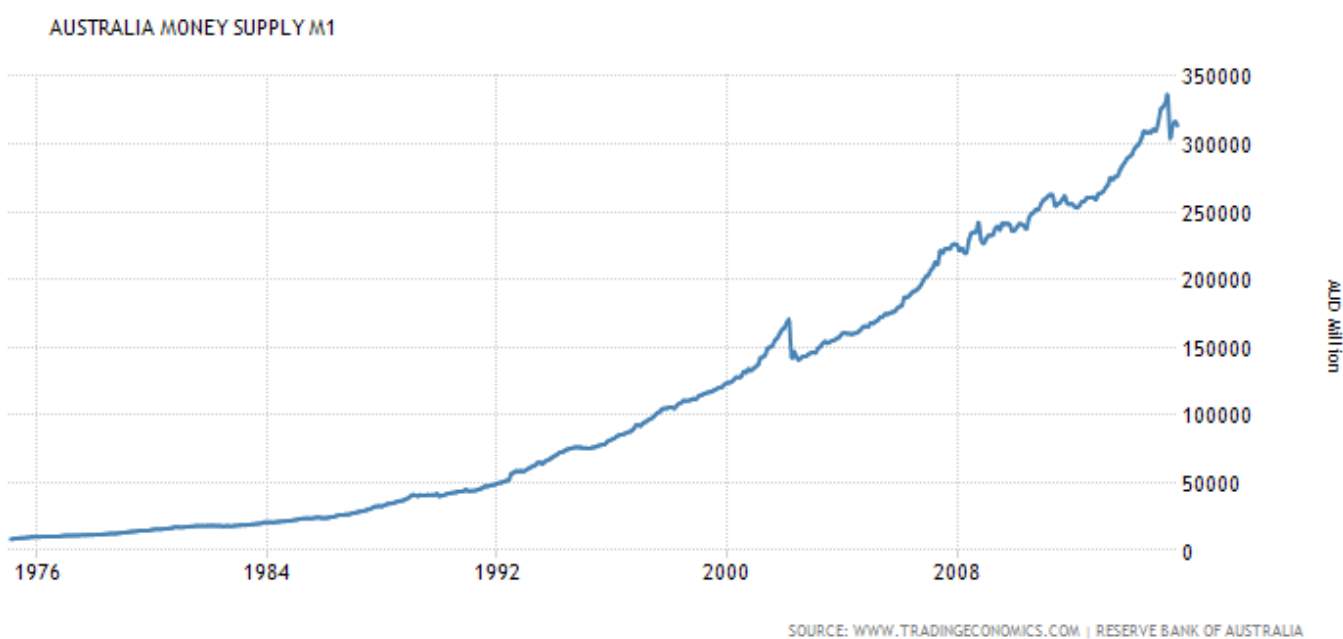
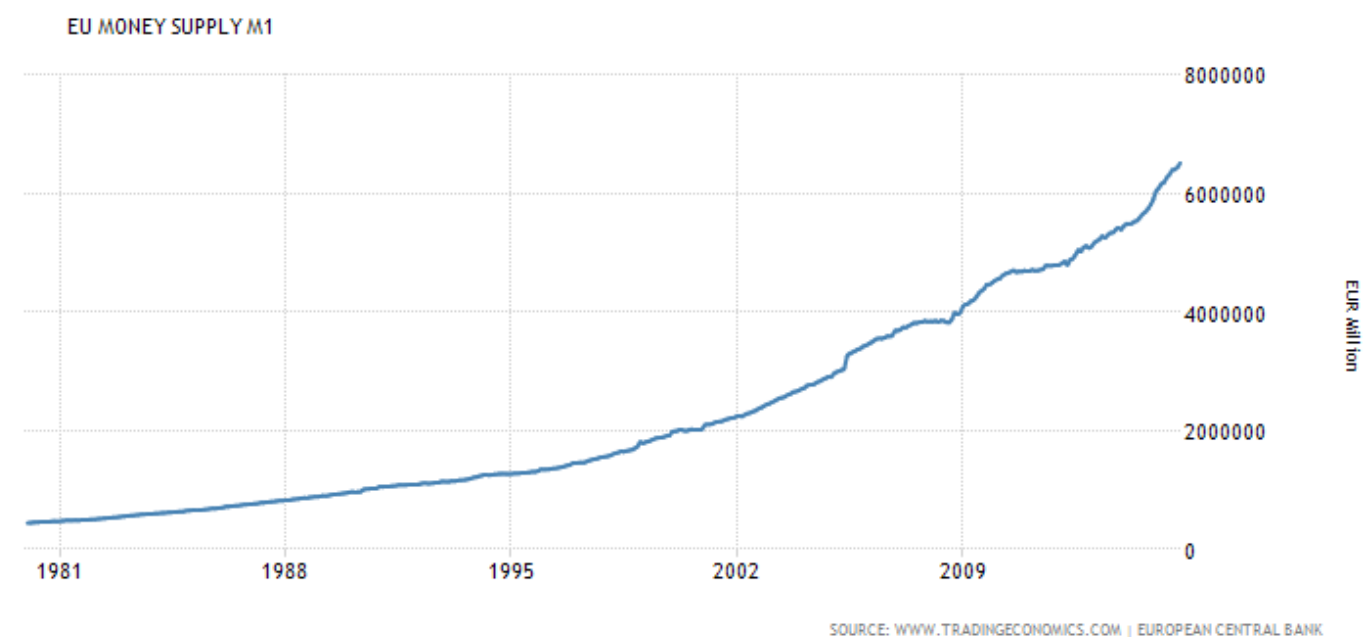


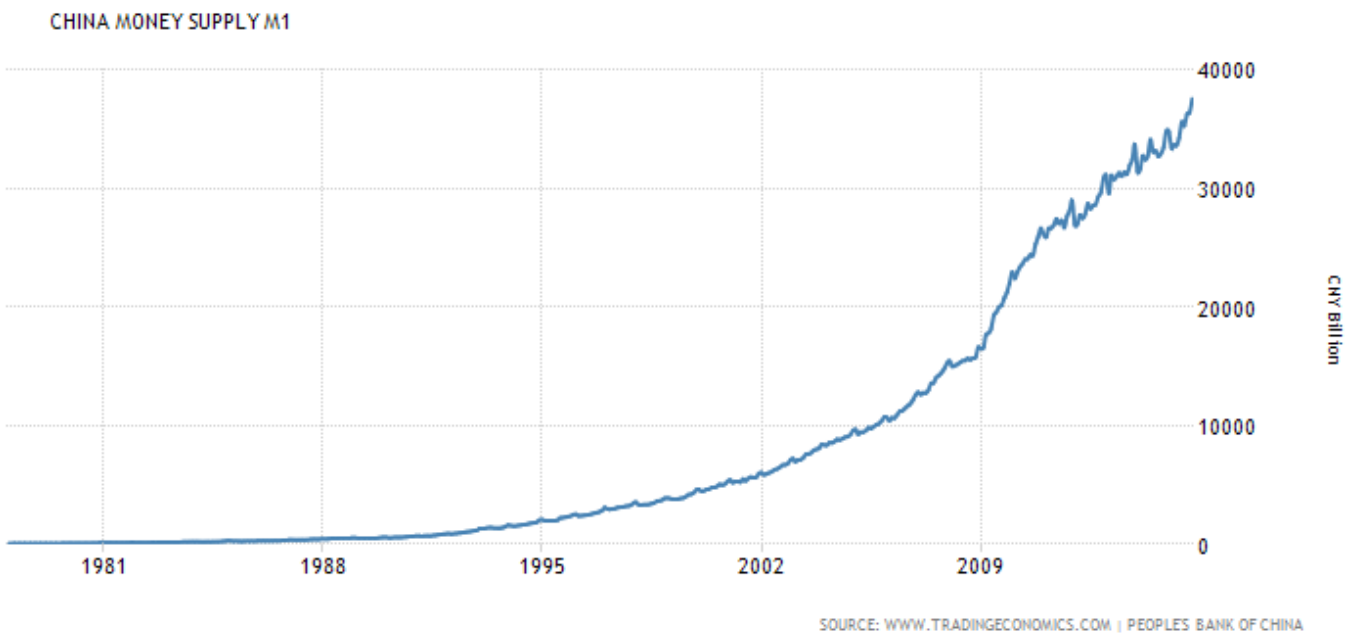
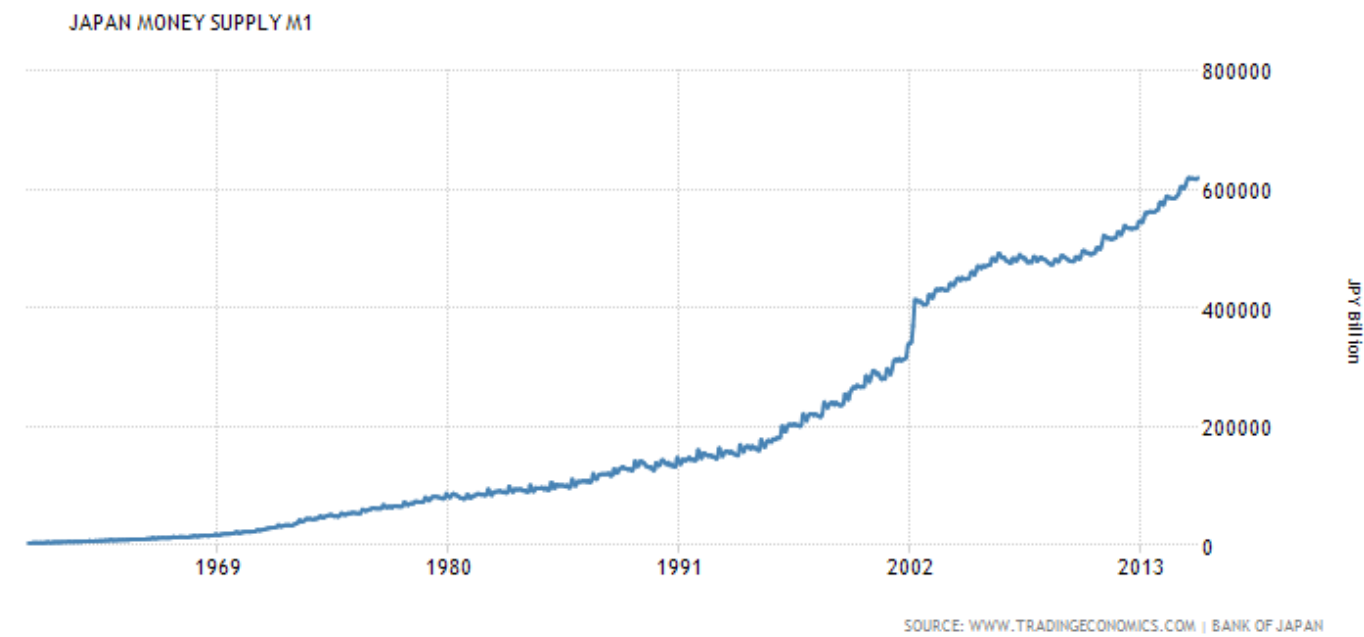
SOURCE: WWW.TRADINGECONOMICS.COM | FEDERAL RESERVE

MEXICO MONEY SUPPLY M1



SOURCE: WWW.TRADINGECONOMICS.COM | BANCO DE MÉXICO





Capital Controls

Capital controls are a serious risk to your wealth and need to be looked out for. Look for the warning signals for capital controls happening such as a worsening economy. If a government says they will not impose capital controls, get your currency out, because they most likely will. This has happened in Greece, China, Cyprus and the US. Capital controls come in different forms, but the most common is the control of the withdrawal of capital from banks.

What are Capital Controls?

Capital controls are a legal policy that restricts the movement of capital (money) in a certain area such as transaction taxes and limits on bank account withdrawals. They are often used in economic crises. Capital controls often stop you from moving your capital out of areas such as the stock market or bank accounts. Often capital controls sets a limit on how much currency a person can take out of their bank savings accounts each day (explained in "The Banking System" section of this chapter) or stop you from getting your currency out of the stock market.

Real Life Examples of Capital Controls

Cyprus: From 2012 to 2013, Cyprus was having a financial crisis with massive bank runs occurring. Those in power imposed a bank holiday along with capital controls on how much currency people could get out of their bank accounts. What was worse is that the banks had a bail-in on these bank accounts with some accounts having a 50+% "haircut". The banks legally confiscated up to 50% of the currency in that specific type of account from the account holders.

Greece: During early 2015, Greece went into a second financial crisis. The runs on the banks were causing the banks to run out of capital and capital controls were imposed. Greek citizens could only get €60 out of ATMs per day. Businesses were also restricted and this resulted in them not being able to get new products to sell, ultimately worsening the crisis.

United States: A couple of states in the US in mid 2015, imposed capital controls on the amount of pension funds retired people could access daily.

China: Due to the fall of the Chinese stock market in 2015 with a drop from its peak in 2014 of 40% to August 2015. China imposed capital controls on the stock market. People were prohibited from getting their currency out of the Chinese stock market. China imposes these controls in a number of ways, one was placing investors that fled the stock market in jail.

Impact of Capital Controls

Capital controls can really screw up an economy in a number of ways. Some of these impacts are:

- Some people can't get access to their currency to cover basic needs any more.
- People can't buy big ticket items any more.
- People will be incapable of dealing with unexpected expenditures such as big fees or taxes.
- Tourism starts declining.
- Businesses can't function correctly.
- All of the above points together cause the economy to breakdown further.

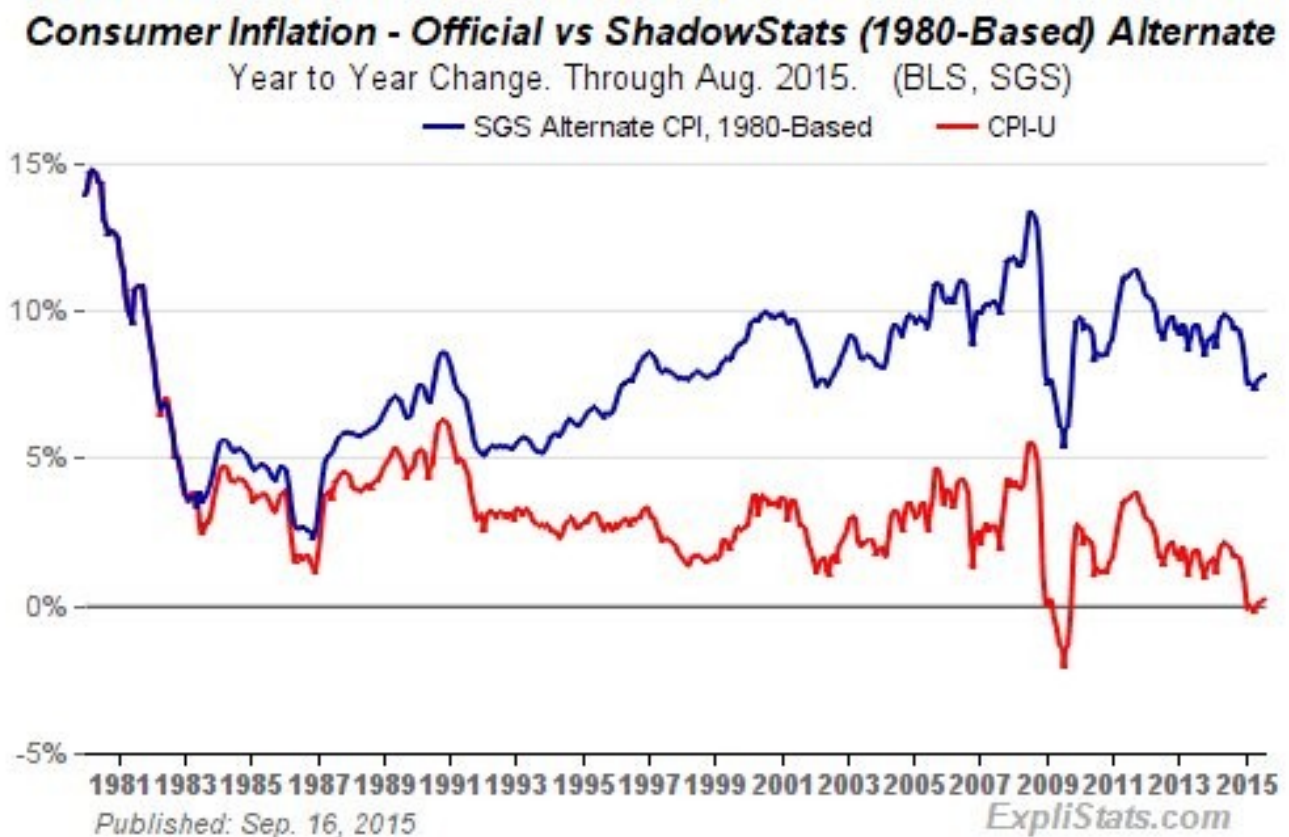
Inflation

This book has looked at inflation in the previous chapter "Money". Its definition has already been explained and this section will look at inflation today and how it's depicted.

Depicting Inflation

Governments depict inflation as inflation rates. However, as you are probably aware, the depicted inflation rates are not entirely accurate. Any person can see inflation is much higher than it is by the continued rising of the prices of items like food, rent, electricity & petrol. Inflation is stated to be as low as 2%, but the cost of living for the majority has increased much more. The Consumer Price Index (CPI) is more accurate in showing real inflation. CPI displays the cost of living based on the cost of a number of items, however governments massage and can change the criteria of the CPI, so it seems lower than what it is. Governments do this to make sure the public doesn't panic and as seen previously this applies to other statistics like GDP and unemployment rates, as well.

Shadow Statistics by John Williams provides a more accurate statistic of inflation rates. To find the inflation rate, Williams uses the method used in 1080. The graph below is inflation calculated by Williams vs government statistics. The great divide in inflation is increasing as time goes on and inflation is actually 8%, which is much higher than the 1% the government says it is.



Source: ShadowStats.com

Endless Inflation

For governments, keeping inflation rates high allows governments to erode their debt away. Their debt reduces in value due to inflation and governments print currency not only to cause inflation, but to pay the debt at the same time. Quantitative easing (QE) causes inflation to stay positive and the governments are fine to keep this going on forever. Kent Conrad states that "Governments can inflate their way out of debt, but that has consequences, doesn't it?"⁶. The consequences are the stealing of the working class's wealth, the drop of purchasing power and that inflation can spiral out of control. The problem is that reversing this policy to keep inflation is almost impossible. QE is only a one way process.

QE: A One Way Process

In *"Quantitative Easing : The Asymmetric Truth - Mike Maloney With Chris Martenson"*, Chris Martenson explains that QE is a one way process. It's a policy that "ease the financial conditions out there to make it easier to borrow by increasing the quantity of money. He explains QE by using mortgage backed securities and PIMCO. The Fed announces that it will buy these securities, so PIMCO will buy them at *"Price x and then the Fed buys then at price x plus something"*. The value of the securities go up and *"All the financial players out there are happy as clams in this process."* But, if the Fed wants to lower inflation and reserve this process then they run into problems. The Fed will be selling these securities, which companies like PIMCO will need cash to buy with, but these securities will depreciate in value so the financial players then aren't happy or won't even buy back the securities. This process in reverse can only work as long as liquidity is in the market. This process in reverse would also cause rates for the mortgage backed securities to rise, which had been very hard to lower using this process normally.⁷

Inflation Erodes Purchasing Power

"Inflation is when you pay fifteen dollars for the ten-dollar haircut you used to get for five dollars when you had hair"

Sam Ewing

Inflation causes the lowering of the purchasing power of currencies. Inflation over the last century has increased rapidly and what people can buy with their currency has decreased rapidly. The price of assets have artificially increased due to inflation. It's not that the assets increase in value, it's that the currencies lose value in relation to the assets due to inflation. The change of prices in varies items will be shown below in the table.

Goods	Price in 1970	Price in 1995	Price in 2015
Fuel Price/Litre in Australia	AUD10c	AUD70c	AUD\$1.10
Silver/ounce	\$5	\$6	\$15
Gold/ounce	\$100	\$400	\$1200
Retail Chicken in US/Kg	\$2	\$5	\$7
Retail Beef in US/Kg	\$2	\$10	\$18
Crude Oil/Barrel	\$10	\$23	\$50

Inflation and Cost of Living

Inflation increases the cost of living. The rise in prices of assets and commodities like food increases much more than income such as the average price of houses in 1970 were \$27,000 and \$270,000 in 2010. While median household income was \$9,000 in 1970 and \$50,000 in 2010. The price of houses increased by twice as much as income did. The 1970s was when inflation started increasing much more.

Hyperinflation

Hyperinflation is when inflation goes out of control. It's literally when currencies become worthless. It has happened many times in history such as in Germany, Ancient Greece and twice in the US.

Deflation Or Inflation

There are a number of believed ways our economy can crash. Some believe, a massive deflation will occur and prices of incomes, homes and assets will plummet and the economy will reduce in size like what happened in the Great Depression with the stock market dropping by 90%. The other scenario is the opposite. As central banks panic from the deflation, they will inflate their currencies into oblivion by printing currencies at rapidly rising rates. The probable scenario that will occur is that there would first be a deflation and then an inflation. Deflation has already started with many assets dropping in value, such as crude oil halving in value recently.

Interest Rates

Interest rates have a big effect on economic conditions of a country. The central banks control the interest rates of countries, which are called the Fed Funds Rate in the United States. Interest rates affect one's ability to get credit. Lower rates make access to credit easier and higher rates reduces access to credit. Interest rates also effect the stock market, inflation and are related to the booms and busts of economies.

Negative Interest Rates

Currently interest rates are extremely low or even zero like in the US. In Denmark, Sweden and Switzerland interest rates are negative! At such low rates, making or paying interest from loans is virtually nothing or in some cases negative. With negative interest rates, a creditor pays the debtor for loaning to them instead of the debtor paying the creditor. Governments have these low rates to make access to credit easy in order to stimulate the economy. Negative rates are also now used to punish savers in order to encourage spending.

Two Bullets in the Gun

Low interest rates and printing currency are the two bullets governments have to avoid recession. Interest rates are already zero and so currency printing is the only option left, which itself, history has shown, doesn't work.

The 2008 Financial Crisis

Increasing interest rates causes people having to pay more interest on their loans. This is why so many people defaulted on their subprime loans in 2008 and cause the crisis. People could barely afford their loans and an increase in interest rates resulted in them not being able to pay back their debts. This is why governments today can't rise interest rates. Firstly, so many people are in debt and they would then default and secondly, the governments are also too far in debt. The low interest rates decrease the amount they have to pay as interest on their debts, but even a slight rise can cause the governments to default. The low rates allow governments to go into serious debt. A rise causes a default like in Greece in 2015.

Interest Rates and Bubbles

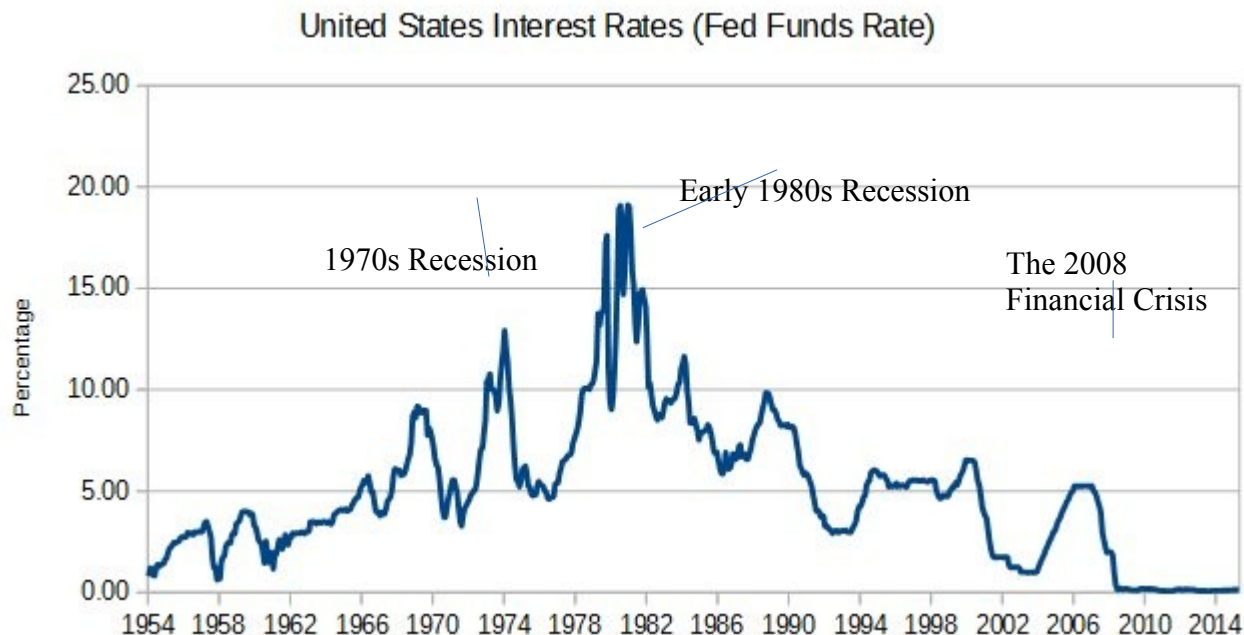
Interest rates can effect bubbles and pop them. The low interest rates have been fuelling the housing bubbles in Australia and Canada and a rise of these rates can pop these bubbles.

Inflation and Interest Rates

Inflation is related to interest rates. Low interest rates can cause increase inflation due to easy credit and high interest rates can reduce inflation by limiting access to credit. The low interest rates today encourage inflation, which the government's prefer to have in order to erode their debt and avoid deflation.

Interest Rates and the Business Cycle

Inflation is also linked with the booms and busts of the economy. Low interest rates are a way to promote economic growth, while higher interest rates tend to cause recessions. Governments will have to raise interest rates during booms to deal with inflation, but this eventually leads to recessions. In the graph below, it can be seen that interest rates are high during booms and peak when the boom ends. The interest rate then declines when the recession occurs to stimulate the economy.



Source: Board of Governors of the Federal Reserve System (US), Effective Federal Funds Rate [FEDFUNDS], retrieved from FRED, Federal Reserve Bank of St. Louis
<https://research.stlouisfed.org/fred2/series/FEDFUNDS/>, November 30, 2015.

Reserve Currency

Throughout time there have been currencies that were widely used and the dominant medium of exchange of that time. These currencies are called reserve currencies. A reserve currency is used internationally and is the main medium of exchange. Products ranging from gold, food and oil are priced in the reserve currency and other currencies are valued against it too. The wide usage and strength of the reserve currency makes it useful for these purposes. It's a currency that can be used any where in the world. Countries also hold reserve of this currency in their central banks for uses such as paying off international debt or manipulating the exchange rates of their country.

Monetary History

For a long time, gold was used as the reserve currency. Throughout ancient times until the 20th century this was the case until the US started taking the world off the gold standard. Gold was used to back reserve currencies throughout the time gold was the reserve currency. It is that gold was given this position through major currencies. In the 16th to 17th centuries, the peso (Currency of the Spanish Empire) was the reserve currency and then the British Pound was the reserve currency in the 18th and 19th centuries. The US Dollar then became the reserve currency in the 20th century, but now the US Dollar is moving away from its position as the reserve currency.

Benefits of Owning the reserve Currency.

When countries do international transactions they have to convert their currency into the reserve currency. This conversion requires a fee. However, the country that has its currency as the reserve currency doesn't have to pay this fee. Due to its wide use, the reserve currency will appreciate in value and maintain a high value. The country that owns the reserve currency has a huge advantage over other countries. This was the case with the US in the 20th century.

The US Dollar as the reserve Currency

Throughout the last century until now, the US Dollar was the reserve currency of the world and the United States benefited from that. The way the US benefited was explained in the chapter "[Money](#)" in section "[Timeline Of Our Recent Monetary Systems](#)". The US used gold, war and deficit spending in order to enjoy prosperity. The economy of the US was going so good during the 20th century, because the US Dollar was the reserve currency. However now, the world is moving away from the US Dollar. The US won't be able to experience such prosperity again after the US Dollar is no longer the reserve currency.

The Abuse of Power

The title of reserve currency allows a country to enjoy more prosperity then normally possible by being able to rig the system. This also happens on a smaller scale with all currencies. Someone who issues currency and controls the monetary system can abuse their power to profit from it at the expense of the people who are made to use that currency. The way issuers of currency have abused their power in this way have been shown numerous times in this book so far such as them being able to print currency from nothing.

"Practically all governments of history have used their exclusive power to issue money to defraud and plunder the people."

Friedrich A. Hayek (Famous Austrian Economist)

The Dollar Crisis

We currently face the issue of the Dollar Crisis. This crisis involves the world moving away from the US Dollar and the Dollar Standard to a new monetary system. As time goes on more events occur that signal the end of the Dollar Standard and the current currency wars are a part of this. Countries throughout the world are depreciating their own currencies against others to achieve a lower exchange rates and make exports cheaper. The currency wars are literally a competition between countries to get their currencies down to zero.

Nails in the Coffin

As time goes on, events that mark the end of the Dollar Standard are occurring faster and faster. They used to occur yearly, then monthly and now daily. Some nails include the numerous bilateral trade agreements between countries to avoid using the US Dollar, countries hoarding gold and countries trying to establish other currencies as the reserve currency. The Chinese Yuan is a likely candidate to replace the US Dollar and China has been doing many activities to try and achieve this such as opening their own version of the World Bank.

China and the US

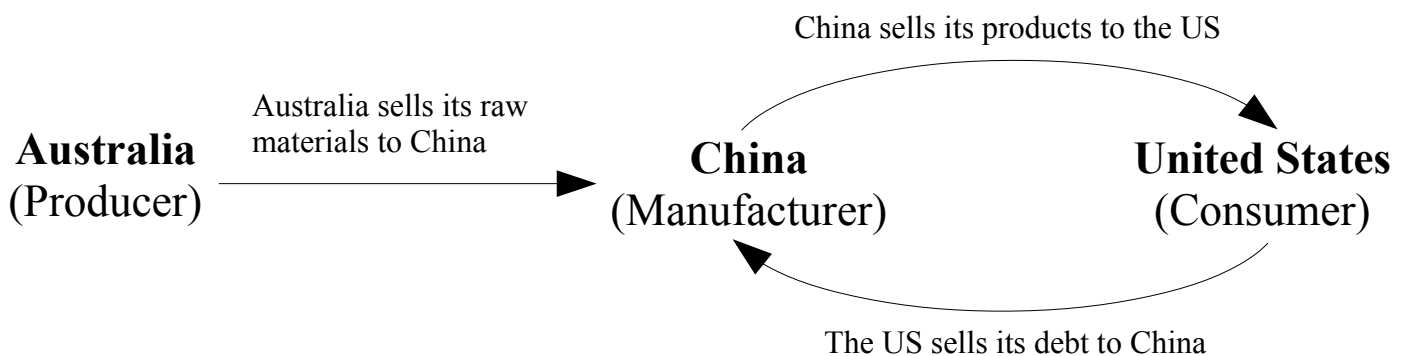
Recently, China and the US have been engaging in currency wars as their agreement between each other starts to crumble. The relationship between these two superpowers is very important right now and this relationship will be explained next.

China and the United States

In the 2000s the US and China started a relationship between them. China would be the manufacturer and the US would be the consumer. China was a manufacturing nation that boomed from this relationship and Australia also got a share from it. However with China slowing down, this relationship is falling apart.

How this Relationship Works

China would manufacture lots of cheap products and sell them off to the US, who would then consume them. China also bought the debt of the US, which resulted in an appreciated US Dollar and a depreciate Chinese Yuan, which made Chinese exports cheaper. This was a win win situation. Australia benefited from this relationship by selling its raw materials to China to manufacture into goods. This relation is visually displayed below.



"In effect, the People's Republic of China has become banker to the United States of America."

Nail Ferguson - "The Ascent of Money"

Why this System is Finite

This relationship is unsustainable and its limitations are already being seen. This system requires a trade deficit by the US. A trade deficit is where imports are greater than exports. A country with a trade deficit isn't producing enough and will need to go into debt to pay for these imports, which the US does by selling its debt to China. China has become the main buyer of US debt and for this system to continue, the US will have to keep going further into debt, which we already know is finite.

Massive US Trade Deficit

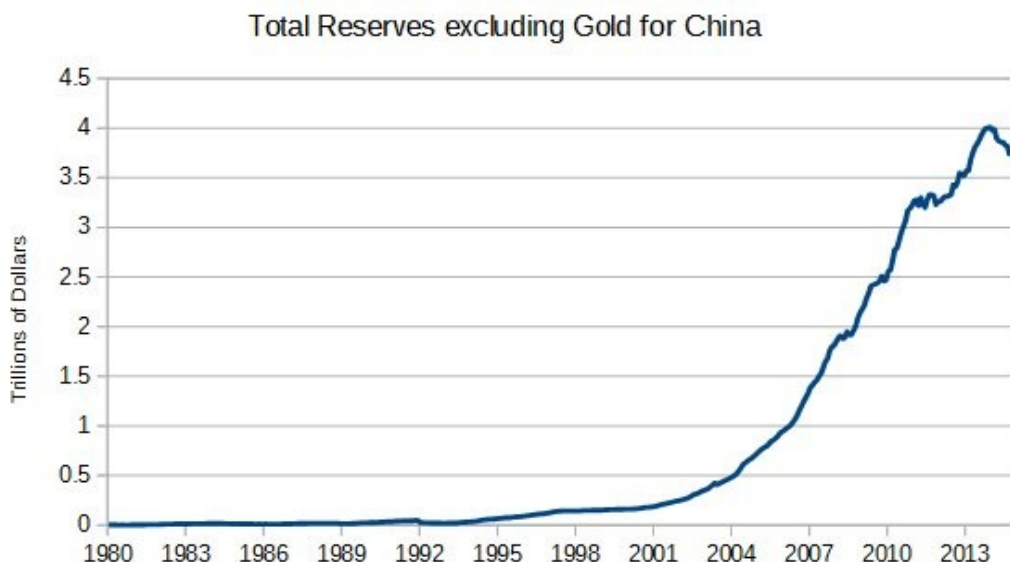
In 2014, the US exported only \$120 billion to China, while they imported \$466 billion, which results in a huge deficit of \$346 billion. The trade deficit to China in 2015 made up 80% of total US deficit. These large levels of deficit aren't sustainable and it's resulting in a mountain of debt for the US.

China's Slowdown

China's economy has been heading into recession for the last few years. China isn't manufacturing as much as it used to and so isn't buying as many raw materials from Australia any more. This brought an end to Australia's Mining Boom and Australia went into a recession.

China Slides into Recession

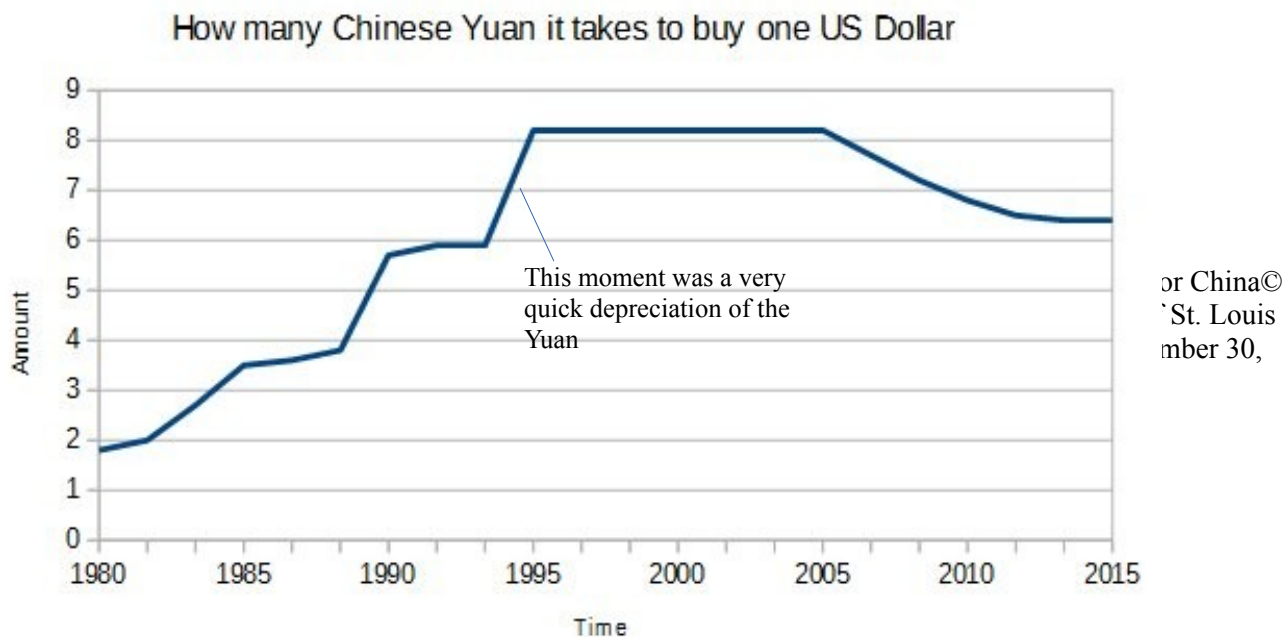
China's recession has recently gotten worse after its stock market started dropping from its peak in mid 2015. From its peak the Shanghai Stock Exchange Composite Index fell by 40% by September 2015. China started using its foreign currency reserves to force a recovery for their economy and to combat the fall in the stock market. The graph to the right shows how China has already sold off US\$300 billion of there reserves. The catch is that most of these reserves is US debt and with China not buying US debt in such large amounts any more this system is in trouble. The Fed will have buy up even more of the US debt and this will cause an appreciation of the Chinese Yuan and a depreciation of the US Dollar, which will endanger the relationship between China and the US.



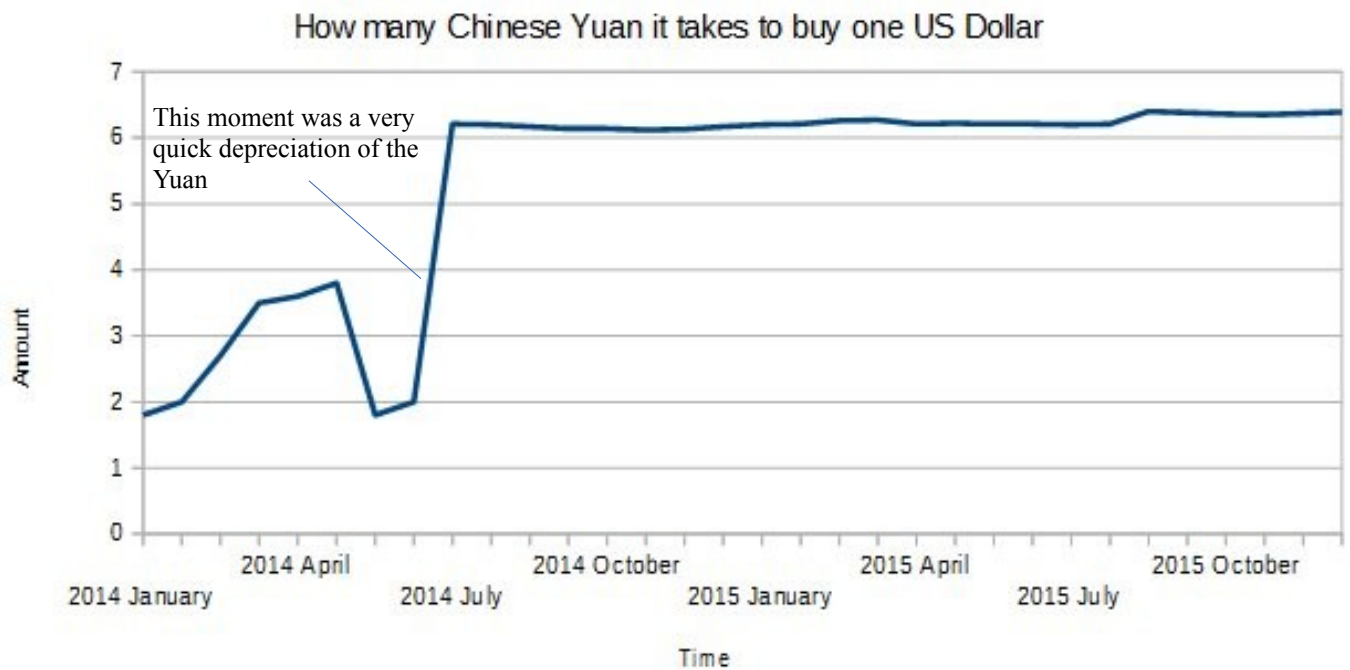
Source: International Monetary Fund, Total Reserves excluding Gold for China© [TRESEGCNM052N], retrieved from FRED, Federal Reserve Bank of St. Louis <https://research.stlouisfed.org/fred2/series/TRESEGCNM052N/>, November 30, 2015.

Currency Wars

The breaking down of this relationship has resulted in currencies wars between these countries. China firstly started appreciating the Chinese Yuan, but now are devaluing it. The two following graphs from Trading Economics looks at the value of the Chinese Yuan in relation to the US Dollar. The first graph shows how the Yuan has been manipulate to stay artificially lower then it should be since 1995 and that after 2008 the manipulation is failing. The second graph looks at how the Chinese Yuan got a massive revaluation after being unpegged from the US Dollar. Pegging is when one currency's value is kept at a certain ratio to another currency and pegging often has large ramifications. China keep their currency pegged by buying US debt and when they slowed this process down, the Chinese Yuan got a revaluation. China after this unpegging has revalued the Chinese Yuan several times.



Source: WWW.TRADINGECONOMICS.COM I OTC INTERBANK



Source: WWW.TRADINGECONOMICS.COM I OTC INTERBANK

IMF

The IMF is an international organisation headquartered in Washington, USA and founded in 1944. The definition of the International Monetary Fund (IMF) is *"The International Monetary Fund is an organisation of 187 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world"*⁶.

The Truth

The IMF is an organisation that tries and fails at trying to support the world economy. The IMF uses taxpayers' currency to bail-out big banks, big businesses and governments. When a country has economic troubles, the IMF will bail-out that country under certain terms and conditions that remove the freedoms of that country's population. These terms are often called austerity measures. The bail-out currency is given to the rich and not to the poor, who are the ones who need it most. The IMF prolongs the problems of a country it gets involved with or even makes conditions worse. So, using this information the definition of the IMF would be "The International Monetary Fund is an international organisation that takes currency from the poor and give it to the rich, while imposing austerity measures on that country it is dealing with."

Greece

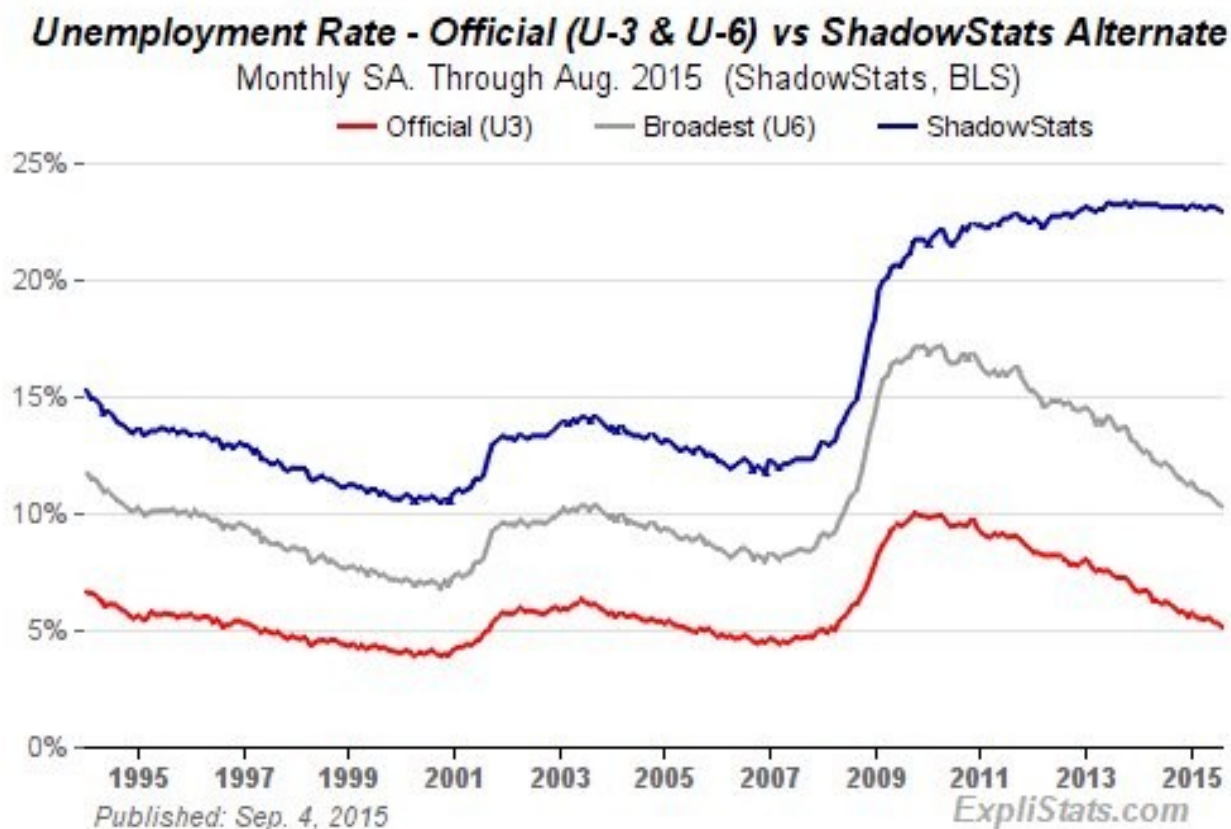
The role of the IMF is not any more clear then in Greece. In 2011, Greece received a \$47 billion bailout from the IMF to deal with its debt crisis. Yet, the IMF's involvement made the economic conditions in Greece worse and Greece got another bailout in 2015 with even more austerity measures. We can presume this problem will continue. In the "[History as Now](#)" chapter, the debt crisis in Europe will be discussed in greater detail.

Poverty

There are several indicators that show how bad things really are. These indicators include food stamp rates, unemployment rates and poverty rates, but governments have changed the criteria for these statistics just like they do for inflation rates. What people need to understand is that the living standards of the general population will determine how good an economy is. Franklin Roosevelt in 1932 said that *"The success or failure of any government must be measured by the well-being of its citizens"*⁹. He is saying that for an economy to succeed, the general population must have a good "well-being". Having a middle-class is important to have a good economy and today the middle-class in Western countries is vanishing.

Unemployment Rates

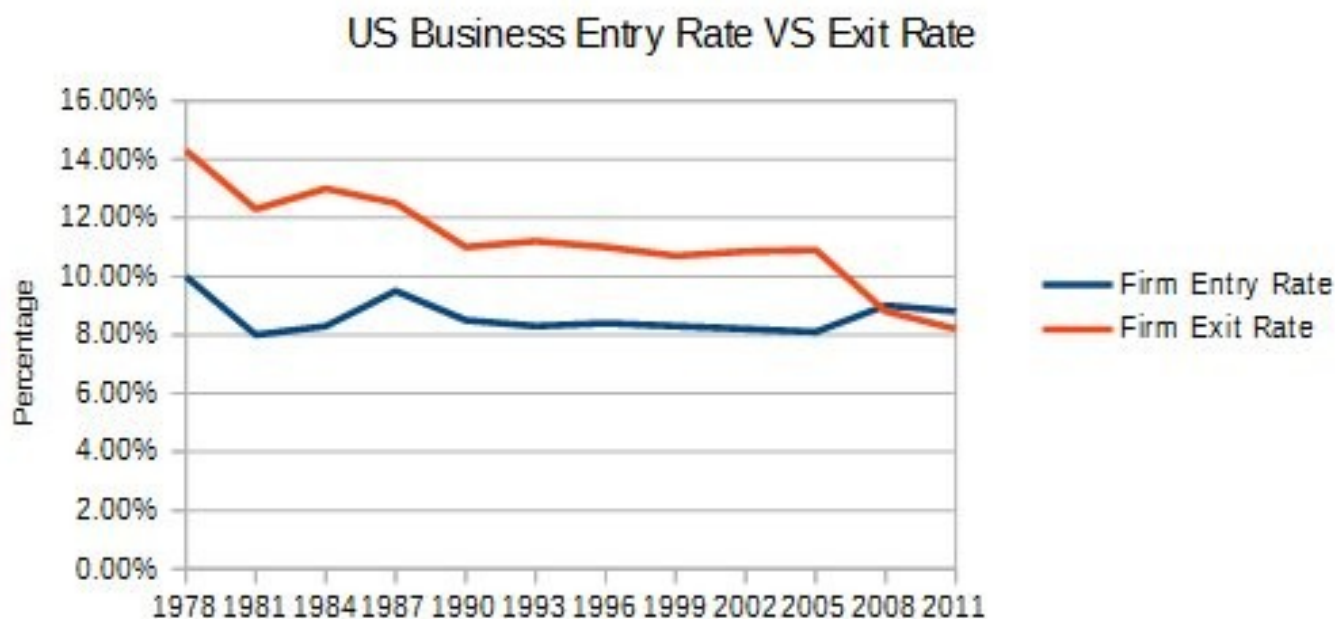
Unemployment rates are one indicator to determine how good an economy is. Many Western countries, especially the US are experiencing high unemployment and people can't spend as much any more. If people don't have an income they won't be able to spend. The graph below is from Shadow Statistics and it shows the deception of the US government statistics. In their statistics, government don't include underemployed people and people that aren't looking for work any more. Many choose not to look for work as the unemployment benefits outweigh the benefits gained from working. The underemployed are those that are underpaid or those that can work to their potential such as a doctor working as a clerk. Most of the jobs created after the 2008 Financial Crisis in the US were minimum waged jobs. High paying jobs are needed for an economy to recover not minimum waged jobs. However all the high paying jobs are being shipped overseas because Western countries have tax laws and regulations that force these jobs overseas. This graph clearly shows the great inaccuracy of the official statistics, which are 5%, while the proper statistics are 23%. This is almost as high as it was during the Great Depression.



Source: ShadowStats.com

Business Failings vs Starting

Businesses can't operate under all these new anti-business and pro-employee laws and in the US, more businesses are failing than starting up. This is a clear sign that something is wrong. This divide is shown on the graph below. The last time this happened, it was during the Great Depression.



Source: U.S. Census Bureau, BDS; authors' calculations

Other Indicators

Food Stamps: Food stamps are given to people that can't even afford food in the US. Before 2000, these rates ranged from 18% to 25%, but now (2015) almost half of the US population are on food stamps. These rates have more than doubled since 2000.

Welfare: 35% of Americans are on government welfare programs in 2015.

Medicare: 50 million Americans are on Medicare as of 2015.

Poverty: According to Supplemental Poverty Measure there are 48 million Americans in poverty in 2014.

Government Dependent: 50% of Americans are dependent on the government either through pensions, unemployment benefits, social security, welfare and Medicare in 2015.

War! What Is It Good For?

Some believe war is good, but it isn't. The song "War" by Edwin Starr states that there is nothing good about war. War leads to destruction and causes economies to slide into recession. Only a few benefit from war.¹⁰

The Cost of War

Governments have to engage in deficit spending to pay for war. The funds come from increased taxes, debasing currencies or taking on debt that has to be paid off in the future. The debt of countries soar during wars and in some cases wars lead to an economic collapse. Funding a war is really expensive and too much of it can ruin an economy, often in the form of a hyperinflation after massive currency creation like for Germany after World War I, the Confederacy in the American Civil War and the US in the Revolutionary War. During war, the economy is also focused on war production instead of consumer products. The country can't produce consumer goods any more and so has to spend even more to get these from trade. The country also can't get the capital any more from exporting these goods. The cost a war has on an economy is seen how World War II effected the stock market. It took around 25 years for the US stock market to rise again after the Great Depression.

The Benefit of War

A few people have used war to their advantage, but these are a few select individuals and countries only benefit from war when they aren't in it like the US in World War I and World War II. The United States wasn't involved in most of these wars and was selling consumer goods to the countries fighting and the US was able to get most of the world's gold. This example has been explained in greater detail in the previous chapter "[Money](#)" in the section "[Timeline of Our Recent Monetary System](#)".

The US is Always at War

The United States have been at war almost the entire time of its existence. The expenditures from war are making up an even greater part of the US Government budget as they overextend their military across the world. The United States now has troops in almost every country and often empires collapsed when their military spread too thin. We should take a hint from history and see that the US empire is now ending.

History

History is just as important or more important than the theoretical side of things. History allows us to understand concepts in economics, why things are the way they are now and more importantly, history gives us an insight into the future. Winston Churchill said "*The farther back you can look, the farther forward you are likely to see.*"¹¹ History shows us how this crisis will unfold and what is surprising is how history keeps repeating and people never learn from it. This chapter will look at economic history, especially the last century. By reading this chapter, you will see how people like the ones at Enron never seem to learn from history.

Review on Monetary History

As this chapter looks at history, we will review monetary history briefly, which was mentioned in the chapter "[Money](#)". Go back to that chapter if you need more information on monetary history before moving on. As already explained, people first traded livestock then crops in a bartering economy. Then money was invented in Asia Minor and its first big use was in Greece before money spread throughout the world.

From Money to Currency

When money was first invented, it was sound money, but over time it turned into currency. The reason for this was because paper currency was easier to use than money. Bartering goods was slow and cumbersome. Money in the forms of gold and silver was much easier to use than bartering goods. These coins are durable, easy to carry and store lots of value in a small place. Paper currency took this further and people could carry a few lightweight notes instead of heavy gold and silver coins. Then came digital currency, which isn't even in physical form and millions of dollars can move around the world in seconds. Digital currency made many transactions much easier. However as money turns into forms like paper, money turns into currency and problems develop.

Crisis of the Third Century

The Crisis of the Third Century isn't a very well known event. The reason for the Roman Empire's collapse isn't well known and people pin it to many different factors, but the main factor in the demise of the empire was economic. The Crisis of the Third Century was an economic crisis the Roman Empire went through, which almost caused the empire to collapse, but besides getting through this event the empire never recovered fully. After this event the empire slowly decayed. This is one of the earliest examples of a society breaking down due to poor fiscal policies and it should be a warning for now as many mistakes done then are reoccurring now.

"Those that fail to learn from history, are doomed to repeat it."

Winston Churchill

Economics of the Roman Empire

The Roman Empire had one of the first complex economies. The Roman Empire was based on slaves, agriculture, trade and mining. The empire was an expansionist economy, which is where they get money from looting and conquering other cultures. Through conquests the Roman Empire acquired a large source of income, but when Empire stopped expanding in the 2nd century, they started facing monetary problems. In the Roman cities an early form of capitalism existed where consumerism was rampant. One example of the squandering of the rich was when an owner of a cook book bought enough food for a party for his friends that it could of feed the whole empire. The city of Rome itself had a large dump of jars and pots outside it that accumulated over time. The Romans had changed their monetary system several times throughout the time of the empire, but it was based on gold, silver, bronze and copper coins. The Empire had a tax system and a simple banking system that involved borrowing and the banks didn't have much capital. It wouldn't be until the renaissance until banking really took off. The Romans were also very efficient in mining with once their world output at that time, reaching world output during the Industrial Revolution for some metals. During the time of Augustus, the Romans used water to blow apart a large mineral-rich mountain for mining. For trade the empire had a good road system built, but trading by boat was still preferred as it was easier.

The Crisis Comes

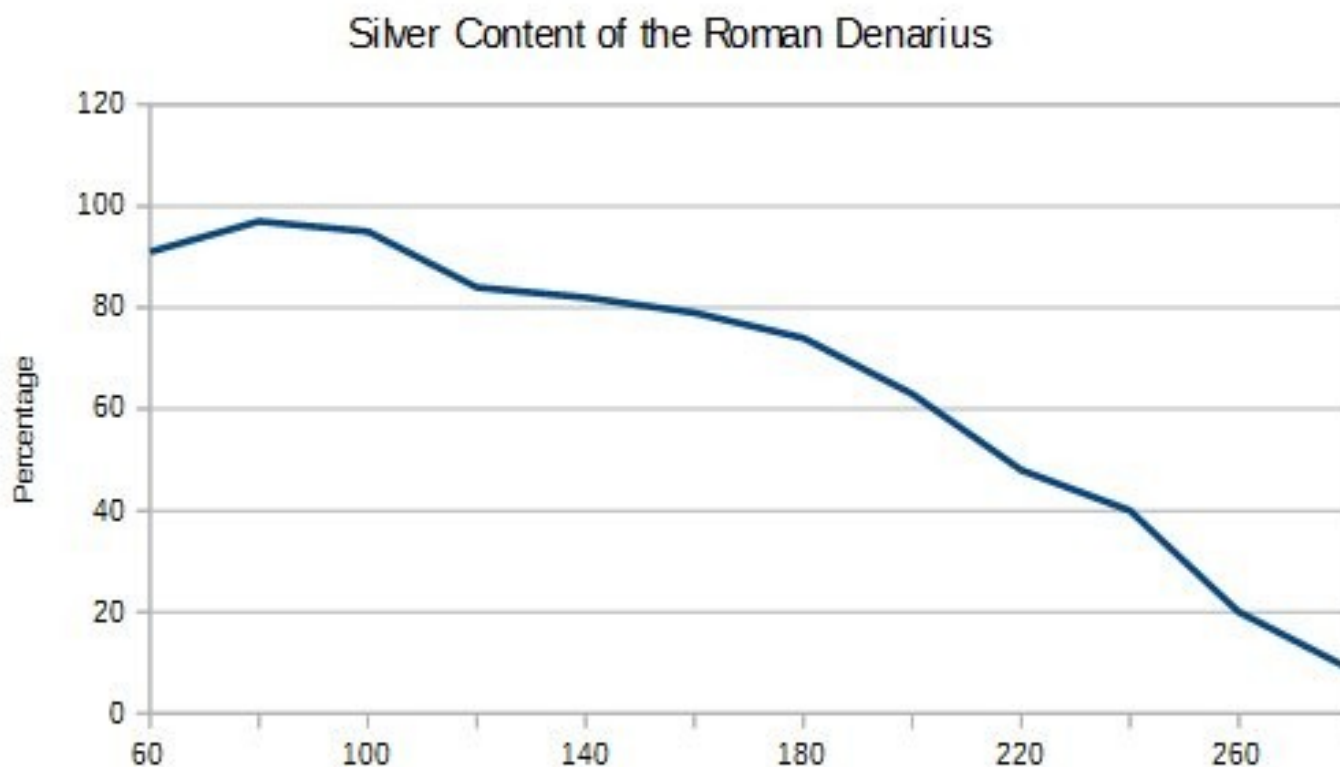
The Roman Empire economy was fuelled for a long time by plundering other nations during its expansion. This gave the empire a large source of income, but when the empire stopped expanding, this source dried up and the empire had massive expenditures at that time and few other income streams. The empire wasn't accustomed to a non-expansionist economy and so started suffering with not having enough revenue. The empire had to find new sources of income, which included debasing their coinage, increasing taxes and going into debt. The expenditures of the government were already huge and military was making a larger part of it as time went on. The military costs increased due to increased soldier's wages, wars and the expansion of the army by a third. The empire also created more administrative centres to control their population, but this also increased expenditures. As things developed the empire would be plagued with inflation, civil war, invasion and civil unrest.

Caracalla

In the turn of the 2nd to the 3rd century, the Roman Emperor Caracalla ruled the Roman Empire. He expanded wages of soldiers by 50% and he doubled the inheritance taxes. He also made it much easier for people to become citizens so they had to pay taxes and citizenship, which once was a privilege, became a burden. He also debased the coinage of the Empire. Caracalla was the first emperor that really kicked off the crisis, he increased expenditures, taxes and currency creation, all policies we have learned that are bad for an economy.

The Crisis!

After Caracalla during the entire third century the Empire was in chaos. During the greater part of the century the Empire was at war, mostly involved in civil war. The 26 different emperors of this time were militaristic and came to power through military means and they adopted similar policies to that of Caracalla that included rising taxes and debasing their coinage. The Empire also was attacked by barbarians and with all this war going on, the military expenditures had to be mind blowing. The graph below shows the debasement of the Roman currency, which eventually led to hyperinflation and the near collapse of the Empire. It was because of Diocletian and an end to the fighting that saved the Empire, Diocletian made big reforms and reformed the monetary system. Other emperors later on like Constantine would continue to solve the problems, but the damage had been done. The emperors would soon revert and continue Caracalla's policies due to increasing government debt from reduced government income and increased government expenditures. These policies would eventually lead to the collapse of the Empire.



Source: Zero Hedge/Tulane University (2010)

The Pattern

A pattern repeats in complex economies like in the Roman Empire. As the civilisation can't pay its expenditures and goes into debt, its economy starts sinking, dragging the civilisation with it. The government responds with increased taxes and debasement of their currency, which will lead to hyperinflation and collapse of their civilisation. During this time the middle-class disappears and the wealth and rights goes from the working class to the rich. What is needed to be understood here is that economic crises like these are the golden age of the rich and the dark age for the poor.

The Corrupt Roman State

The barbarians are seen as an enemy to the Roman people and are considered bad, but the barbarians are the ones who saved the Romans from a corrupt system. The earlier Roman Empire might have had a good social system, but the latter Empire's social system enslaved the common people. The barbarians freed them from that. The rich used the monetary system and their power to benefit themselves. Professor Joseph Peden in his lecture "Inflation and the Fall of the Roman Empire" discusses about how monetary systems are designed to benefit the rich by stating that *"Monetary, fiscal, military, political and economical issues are all very much intertwined and they are also intertwined because any state normally seeks to monopolise this supply of money within its own territory. Monetary policy therefore always serves, even if it serves badly the preside needs of the rulers of the state if it also happens to enhance the prosperity and progress of the masses of the people that is a secondary benefit, but its first aim is to serve the needs of the rulers, not the rule."*¹² He brings to light the corruption in the Roman Empire, which is also the same corruption in our current society.

The Monetary System

During the crisis the token coinage (Intrinsic value is less than fiat value) of the Romans was uncontrolled and many counterfeits were made and cities minted their own token coins to pay expenditures. When token or debased coins were given to civil servants and soldiers, prices rose and the governments then made taxes and salaries to be paid in goods and services to avoid the rising prices. Constantine changed this by making gold the main form of coinage. Taxes and salaries were paid in gold and the price of gold rose. Gold was a hedge against inflation and the rich owned most of it and the common person was stuck with token coins. This caused the rich to have a stable monetary system and the rest to have an inflationary monetary system.

Life During the Late Roman Empire

Day-to-day life for the common person was very tough. The upper middle-class called Decurions were forced to collect taxes for the state and they would have to pay any taxes they couldn't collect themselves. The state made it easy to get into this class and made it illegal to leave it. During the crisis, people had to pay taxes in goods and so were forced to work for the state. During this period, commoners could not change their occupation and also commoners' occupations were made hereditary.

Diocletian also imposed many burdens on the working class. Firstly, he made small landowners be forced to keep their land and work it, which is similar to serfdom. Diocletian secondly calculated the production levels of each province to set a standard tax on each province. Even if the production level lowered in a province, they still had to pay the taxes for normal production levels. Thirdly, Diocletian set a price control all over the Empire to control inflation. There was a maximum price that could be set in a province and prices were far below the market price in provinces with high costs of living. Diocletian's and other emperors' actions limited the rights of the working class and increased the taxes they had to pay.

What we Learn From This

We learn what can happen in an economic crisis. The ruling class sets up policies to protect the ruling class at expense of the middle and lower classes. The working class and businesses have their rights taken away and the wealth is transferred to the rich. This pattern occurs throughout history. Peden at the end of his speech summarises this pattern, which occurred with the Romans, by saying "The Roman state was the enemy; the barbarians were the liberators. And this undoubtedly was due to the inflation of the 3rd century. While the state had solved the monetary problem for its own constituents, it had failed to solve it for the masses. Rome continued to use an oppressive system of taxation in order to fill the coffers of the ruling bureaucrats and soldiers."¹²

Origin of Banking

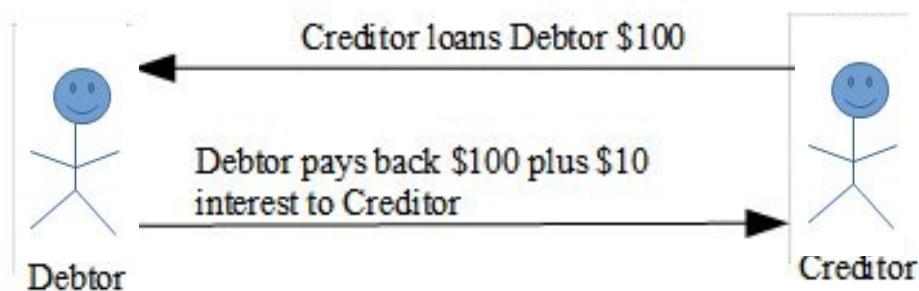
Banking has been around since ancient Rome, but the Romans only had a very simple form of banking and it wasn't until the renaissance when banking really took. Early banking was simple and bankers were faced with difficulties such as laws and slow movement of communication.

Credit

When money was invented it allowed for many new forms of finance to form, which included the idea of borrowing. Niall Ferguson in his film "The Ascent of Money" outlines that *"There was one huge possibility created from the emergence of money...that would revolutionise world history. It was the idea that you could rely on people to borrow money from you and pay it back at some future date."* This was the underlining principle of banking, which is known as credit. Ferguson also indicates the origin of credit came from the Latin word "credo", which means "I believe". Ferguson here shows us that the Romans had an understanding of credit and simple banking.¹³

Simple Banking

The underlining principle of banking is credit (ability to use products before paying for them) and the process of using credit is borrowing. A creditor is the person, who loans the money out to the debtor, who will have to pay the principle (amount borrowed) sometime in the future plus interest for the risk the creditor took for loaning out their money. This is the basic principle from which all the complex systems of banking evolved from.



The Merchant of Venice

Venice is well known for being a city of finance and banking. During the Middle Ages, Venice was the European capital of money lending. When we think of Venice we often think about banking and money. Trade was flourishing here, but they needed ways to finance their voyages and they had to turn to the loan sharks of Venice to get their funding. These early bankers of the 13th century were Jewish and unpopular as Christianity made charging interest a sin and this was a major setback for financial development in Europe. Jews themselves were allowed to charge interest, but Christians saw this as a sin and they didn't like them. Shakespeare's play "The Merchant of Venice" really shows how early money lenders behaved and how they were treated.

The Difficulties of being a Money Lender

A money lender had the difficulty of high risk. Any debtor could default on their debt and even one default can be devastating for a money lender. So, a money lender had to be hard with their debtors to make sure they didn't default. A loan shark can inflict harm upon a debtor that defaults to make a statement. Ferguson states that money lenders are *"providing a service, but at a socially unacceptable price."*¹³

From Money Lenders to Banks

The Renaissance saw the development of banks, which solved the problem of making sure debtors don't default on their debts. Money lenders had this problem because they were individuals, but forming banks means getting bigger and having more power. A bank could do more to deal with a defaulter at a socially acceptable price than a money lender could. The way this came about was because of the Medici.

The Medici

The Medici were a very powerful family located in Florence, in 400 years, 2 of them were Queens of France and three of them were Popes. Ferguson expresses the importance of the Medici by saying *"Perhaps no other family left such an imprint on an age as the Medici left on the Renaissance."*¹³ The Medici were bankers, specifically foreign exchange dealers and it would be Giovanni di Bicci de' Medici who would reinvent banking to become profitable, acceptable and a way to achieve power in the late 14th century. Instead of charging interest, he charged a commission for the converting between currencies and the commission was larger when there was more risk. He also gave a compensation to people who put their money into the Medici bank. He used accounting to hide the interest in his bank.

Giovanni also diversified the Medici Bank by decentralising it, so the Medici Bank was formed by several partnerships. This allowed the Medici bank to reduce risk of people defaulting, which many centralised banks had a problem with. The Medici Bank was made up of many different smaller banks and people, which allowed the Medici Bank to spread throughout Italy. The difference between banks and loan sharks is that banks reduce the risk of money lending as stated by Ferguson.¹³ By developing banking into modern banking, the Medici became a very powerful family.

Origin of the Bond Market

"We may think power resides with presidents and prime ministers in places and parliaments. Not so. In today's world, real power lies in the hands of an elite group of unassuming men in anonymous, open-plan offices...the men who control the world's bond market."

Niall Ferguson - "The Ascent of Money"

The bond market is one of the major financial tools that can make people rich. Ferguson in the above statement is saying that the people who control the world's financial markets like the bond markets are the ones who hold all the power. Kings, prime ministers and presidents are their puppets. Governments always seem to engage in deficit spending fearless on how much revenue they make and the bond market allows them to engage in this. The governments raise the extra funds by selling bonds. Ferguson describes the bond market as the "next big revolution in the history of finance" after the invention of banking as it *"created a whole new way for governments to borrow money"*.¹³ The bond market's origins come from war.

The Squabbling Italian States

In the 14th and 15th centuries the Northern Italian states like Pisa and Florence were squabbling with each other causing continuous war for the city states. The city states started facing problems on how to finance the wars and hire mercenaries. The city states fought mainly with these mercenaries, whose loyalty depended on who paid them the most. The city states were dealing with expenditures twice their tax revenues and had to find a way to finance these wars, which led to the invention of bonds. The city states forced their own populations to lend money to the city, who would pay back principle plus interest back to them. The bond owners would also make more money by trading their bonds. But, government bonds only work if they can be paid back. The wars continued and the debt of the city states grew. Florence's debt went from 40,000 florins in 1400 to 5 million florins in 1423. The higher the debts became, the more risk and less worth the bonds had. A country needs its bonds to be of good value for the government to continue this scheme. The build up of debt caused the city states to default on their debts and to cause an economic crisis. Venice got hit harder as several military defeats reduced the value of their bonds causing their debt bubble to pop quicker.

The Fundamentals of Bonds

When a bond is issued it has a specific face value and the interest on that bond is on its face value. However when bonds are traded their value can change. If a \$100 bond is being traded for 10% of its value, you can buy it at \$10 and still earn an interest of it based on its face value. The bond market also effects the interest rates of the whole economy.

Nathan Rothschild

Nathan lived during the Napoleonic Wars and was often called the Bonaparte of Finance. He was a master of the bond market and his involvement in the bond market made his family extremely rich. His success came from the Napoleonic War. Nathan in hope that the Napoleonic War will last long bought up lots of gold as gold's price would rise during war. Nathan wanted Napoleon to win at Waterloo so the war would last longer and he could make huge profits from the rise in the price of gold. However, the British won the battle and the war was over. No one wanted the gold Nathan had and he was facing big loses, so he used his gold to buy British bonds, which was very risky. Ferguson states that Nathan's reason for buying British bonds is that *"The British victory at Waterloo would send the price of British bonds soaring upwards."*¹³ Nathan's gamble was correct and in 1817 he sold his bonds making a profit of \$900 million.

The American Civil War

The bond market also influenced the American Civil War. The Confederacy decided to manipulate the bond market in order to raise funds for the war. They sold Confederate Government Bonds and backed these bonds with their cotton so the value of cotton would decide the value of their bonds. The Confederacy would increase the value of their bonds by limiting the amount of cotton they sent overseas. This caused a shortage of cotton in Europe and a rise in the value of cotton and the Confederate bonds. Britain's main industry was textiles and 80% of their imported cotton came from the Confederacy, so this shortage hit them rather hard causing cotton production in Britain to stop in late 1862.

The Confederate manipulation of the bond market worked until, the Union took over New Orleans in mid 1862, which was the main port of exporting cotton. This was a problem as the Confederate strategy required that they could supply cotton to bond owners when required, but the loss of New Orleans disallowed that and the value of the Confederate cotton backed bonds began losing value. What was made worse was that the British had acquired new sources of cotton. So the Confederates were forced to print their currency into hyperinflation to fund the war. The true turning point of the war was the capture of New Orleans as it marketed the end of the Confederacy's ability to be able to fund the war.

Origin of Stocks

Not many people know that the stock market has actually been around for a long time. The stock market actually came into emergence in 1602 in Amsterdam. The Dutch were the first that came up with the idea of companies and stocks, but it would be John Law who actually took the stock market to the next level. It seems that stocks, money and banking follow a similar pattern. It was invented, but remained small and then someone would develop and upscale it. The Greeks made money become mainstream, the Medici made banking become big and John Law would do the same with the stock market.

The Dutch Stock Market

The Dutch by 1690s had developed many areas of finance, they created a national lottery, the first central bank and the company. The Dutch expanded throughout the world and created companies and in 1602 these companies created the United Dutch East India Chartered Company. This company's value was divided between Dutch people. People invested into this company and after 1606, they would earn a share of the company's profits. These investors could also sell their share to other investors and this created the first stock market. Ferguson in the "Ascent of Money" details how the Dutch shareholders got very rich from the company by displaying what one shareholder made from the company, *"Dirck Bas's original shareholding of 6,000 guilders had been transformed into a 500,000 guilder fortune."*¹³

John Law

"An ambitious Scot, a convicted murder, a compulsive gambler and a flawed financial genius, he not only caused the first true boom and bust in asset prices, he also indirectly causes the French Revolution."

Niall Ferguson - "The Ascent of Money"

Above is Ferguson's description of John Law. John Law had to flee Britain in 1664 after killing Edward Wilson over Elizabeth Villiers because he was arrested and sentenced to death. Law had escaped prison and made his way to Amsterdam where he examined the way the Dutch stock market worked. Law used the knowledge he got from examining the Dutch stock market to create a whole new way of using the stock market. He went to France to try this and was allowed to try out his experiment, because France was facing heavy financial troubles and were looking for any way out. Law would establish a central bank in France that issued paper currency, which would turn the debt into shares of his new company, "The Mississippi Company" and he could also print as much currency as he wanted too.

The Mississippi Company

The Mississippi Company was the master stroke of Law's strategy, it was a company that would hold monopoly on the trade with the French Louisiana Colony. Law encouraged people to buy shares of the company and like a pyramid scheme huge masses of people bought shares pushing the starting share price from 500 livres in 1716 to 10,000 by December 1719. This is a typical bubble, the rising share price made more people want to buy as they thought the share price would keep rising. But with all bubbles, The Mississippi Company bubble would also have to pop as things must go down eventually. This was the flaw in Law's system. Another problem was that he printed currency to drive up the share price, which is technically QE, which we already know doesn't end well. Despite this he turned the French debt into shares and by 1720, he had become very rich and had control over many areas of the French economy, but it wouldn't be long before it all changed.

The Bubble Bursts

In mid 1720, a group of colonists went to Louisiana and discovered the truth about the region being worthless, which Law portrayed to be a land of plenty. The spilling out about the worthlessness of the company's asset caused confidence in the company to drop. This led to the decline in the share price and Law got the share price to be cut from 9,000 livre to 5,000 livre to try and fix the problems, but it didn't help. By the end of 1720, the share price of the Mississippi Company had fallen by 90%. This resulted in Law losing his wealth and fleeing France to Italy where he spent the rest of his life gambling in Venice. The damage John Law did to France was the continuation of its economic crisis that eventually led to the French Revolution.

The Cost of Government Intervention

The cost of government intervention is seen clearly when comparing the 1920-21 Depression to the Great Depression. The former had little government intervention and the economy had a quick recovery, while the latter had lots of government intervention and the economy stagnated for years. Everyone knows about the Great Depression, yet hardly anyone knows about the 1920-21 Depression, which was over very quickly, because the government backed off and even reduced expenditures. This should be a lesson we should learn from history, yet the world isn't learning.

Keynesian Economics

The person who we have to thank for our economy being in its current shape is the economist John Maynard Keynes. He developed Keynesian Economics, which entails that government intervention is needed for economic recovery. Keynesian Economics involves aggregate demand, which is basically that printing currency will help the economy recover. Governments around the world believe Keynesian Economics works and engage in it, but as already proven by history, Keynes got it wrong. Keynes promotes increased government spending and the effects of this are clearly seen when comparing these two examples.

Exploding Expenditures

Whenever the economy goes to a downturn, the government often intervenes, which results in an explosion of government expenditures. The government will run a huge deficit and build up a pile of debt, which will just drag the economy down further. A government needs to reduce its deficit like in the 1920-21 Depression to fix the problem as huge government debt is often the reason why the economy is in recession as the taxpayers are burdened by this debt. Alan Greenspan once said that "*Deficit spending is simply a scheme for the confiscation of wealth.*"¹⁷ with the wealth being confiscated from future generations.

The 1920-21 Depression

This economic downturn was brought on by the huge deficits from World War I, as seen by the graph showing US Government Debt as percentage of GDP at the end of this section. By 1920 the US Government had debt 30% of its GDP, which over the next few years declined. The US was facing CPI rates above 20% during the Depression and unemployment was at 12% by 1921, however within two years unemployment went down to 2.4% and CPI dropped by 15.8% within a year from its 1920 peak. The reason why things recovered so quickly was because the government didn't intervene, instead they cut federal spending by 65% within a year. Economist David Quinteri points out that the economy recovered "without the massive bailout packages and other means of government intervention."¹⁴ and the free markets were allowed to initiate the recovery.

The Roaring Twenties

"Deficit spending steals prosperity out of the future so it can spend it today"

Mike Maloney

The Roaring Twenties is seen as a time of great prosperity, but much of this prosperity came from the government and the Fed printing currency. Mike Maloney mentions in his Hidden Secrets of Money series that there are "Lots of smoke and mirrors in economics"¹⁵ and these smoke and mirrors hide from the public the real reason of the economic prosperity of the 1920s. The deficit spending allowed for prosperity by taking it out of the future. David Quintieri states that because the "*Level of prosperity was unjustified.*" the Great Depression occurred.¹⁴ The Roaring Twenties boom needs to be looked at as a bubble, which popped in 1929 as the economy re-valuated itself. The boom was fuelled by increasing the currency supply by 60% throughout the 1920s and by lowering interest rates.

The Great Depression

In September 1929, the prosperity bubble popped, marked by the 50% drop of the Dow Jones from 380 to 200. A fake recovery occurred for a while, before the collapse continued with the Dow Jones dropping by 90% from its peak by 1932. The second graph at the end of this section shows this "dead cat bounce" occurring. The dead cat bounce is when you have a short bull in a big bear. The Great Depression also saw an increase of debt to GDP from 20% to 40% due to the contraction of the economy and unemployment reaching 25%. What is alarming now, is that unemployment in the US is 25% in 2015, according to Shadow Statistics. The Great Depression was so bad because of too much government intervention.

Reasons for Crash

There are numerous reasons why the 1929 stock market crash occurred. Firstly the government wanted to keep employment high, because "Their idea was to increase public works in order to fend off the depression."¹⁴ with public works including employment. However this just resulted in increased government expenditures. President Hoover thought that the Keynesian approach to things would work. Robert P. Murphy describes Herbert Hoover's behaving like "a textbook Keynesian after the 1929 stock market crash." Murphy goes on how Hoover increased federal spending by 42% by 1932 from 1930 "to bolster aggregate demand"¹⁶ Hoover also tried to increase construction of houses and he gave banks \$1 billion (serious currency those days) in the late 1920s. Yet all of this failed because it tampered with the supply and demand fundamentals of the free markets. Hoover in the end had to increase taxes by 20% in 1932 to reduce government deficit, but increasing taxes burdens the economy and results in the long-term of less tax being collected and the economy getting worse as said by Allan Greenspan "Whatever you tax, you get less of."¹⁷

Another reason why the Great Depression occurred was the attempt to force high wages to avoid a depression. As David Quintieri puts it, "They seemed to believe that the wages from the boom were supposed to carry on even through the downturn"¹⁶ as low wages encourage downturns. However the forced high wages forced businesses to lay off workers as they couldn't afford to pay them and this caused unemployment to be higher then it needed to be. The burden on the government increased as they could only afford the high wages they enforced.¹⁶ So, the Great Depression was brought on because of artificially high unemployment and prosperity, government involvement, increased government spending and currency creation.

The Aftermath

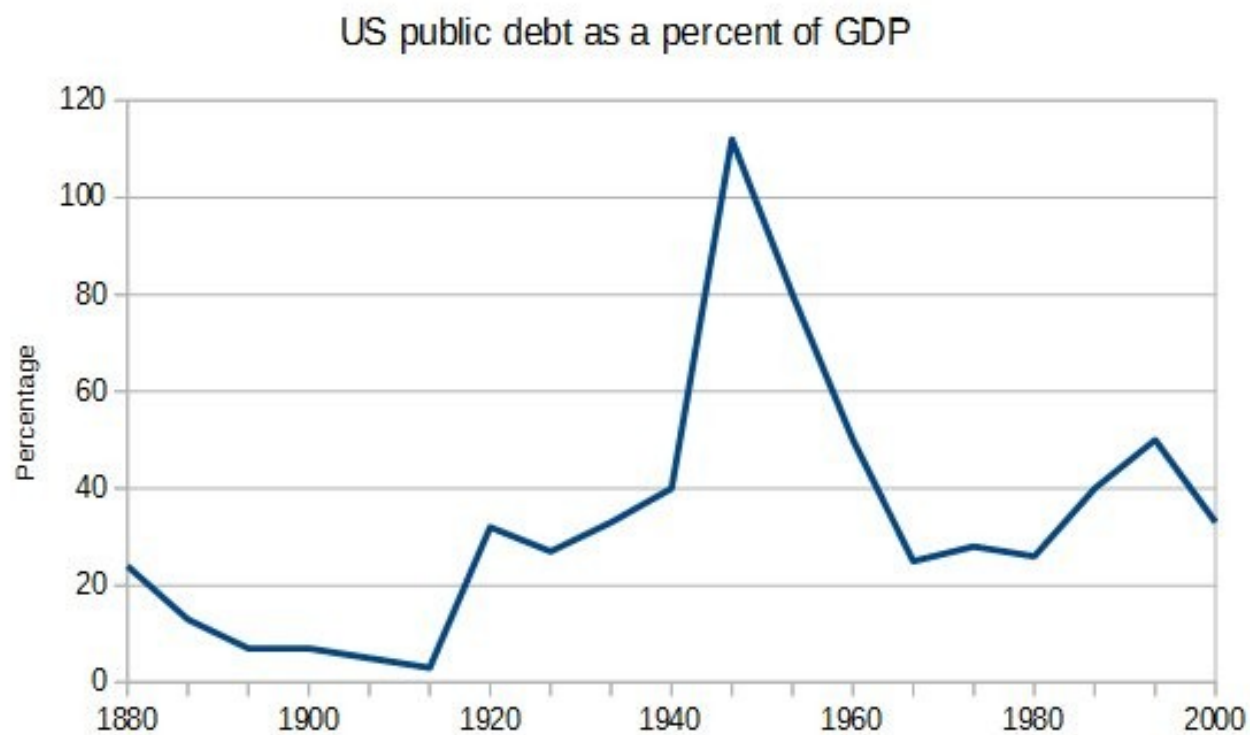
The US economy would stagnant for a long time with the stock market not reaching 1929 highs until the mid 1950s. World War II would come and cause the recovery to take even longer with the government building up a massive debt during the war, with debt becoming larger then actual GDP.

Government Intervention

Too much government intervention is bad, but too little also isn't good, because people then take advantage of that and things like the Enron fiasco occurs. Balance is what is needed, not too little or too much government intervention.

What we Learn from This

The Great Depression shows what too much government intervention does and the 1920-21 Depression shows what happens when the government doesn't get involved and actually reduces their spending. This case study debunks Keynesian Economics by showing that it doesn't work. Murphy says that if the Keynesians were right then the 1920-21 Depression should have been the Great Depression and that the Great Depression respectfully would have been like the 1920-21 Depression. The conclusion to be drawn as said by Murphy is "The free markets work. Even in the face of massive shocks requiring large structural adjustments, the best thing the government can do is cut its own budget and return more resources to the private sector."¹⁶ What this case study is showing us is that the up and coming crisis will be another Great Depression instead of the 1920-21 Depression it could have been if it hadn't been for the government intervention.



Source: Congressional Budget Office



Source: Macro Trends

Weimar Hyperinflation

If one wants to find a prime example of a failed fiat currency system, one has to look no further than Weimar Germany. After World War I, the German government decided to run their printing presses at full speed to hyperinflate the German mark into oblivion. The Weimar Hyperinflation shows us what will happen to our current fiat currencies like the US Dollar. This hyperinflation took place between June 1921 and January 1924.

It's the Allies' Fault

Germany had already devalued the German Mark during World War I when they used printing and deficit spending to pay for the war, but it was the Allies that "helped" the Germans get the inflation under way. The Allies decided to give Germany harsh peace terms that involved financial reparations of £6,600,000,000 to the Allies to pay for the cost of the war. This debt would take decades to pay and the Allies also occupied the German Rhine region and restricted the size of the German military. The repercussions of these terms would be felt by the Allies as Hitler's armies swarmed across Europe.

Economic Crises Create Dictators

Hitler used the Weimar Hyperinflation to try and gain power in Germany. He promised the Germans he would fix the problems and become loved by the German people. His attempt failed and he was imprisoned, but a second economic crisis in Germany in the 1930s brought about by the Great Depression gave Hitler another chance to gain power. His second attempt succeeded and it's the Allies' fault Hitler gained power through Germany's economic troubles as the Allies caused these troubles. Throughout history, dictators gained power during economic crises and this can happen in the up and coming economic crisis today, so we need to be very careful. Having a dictator rise to power is dangerous and they will take our rights away.

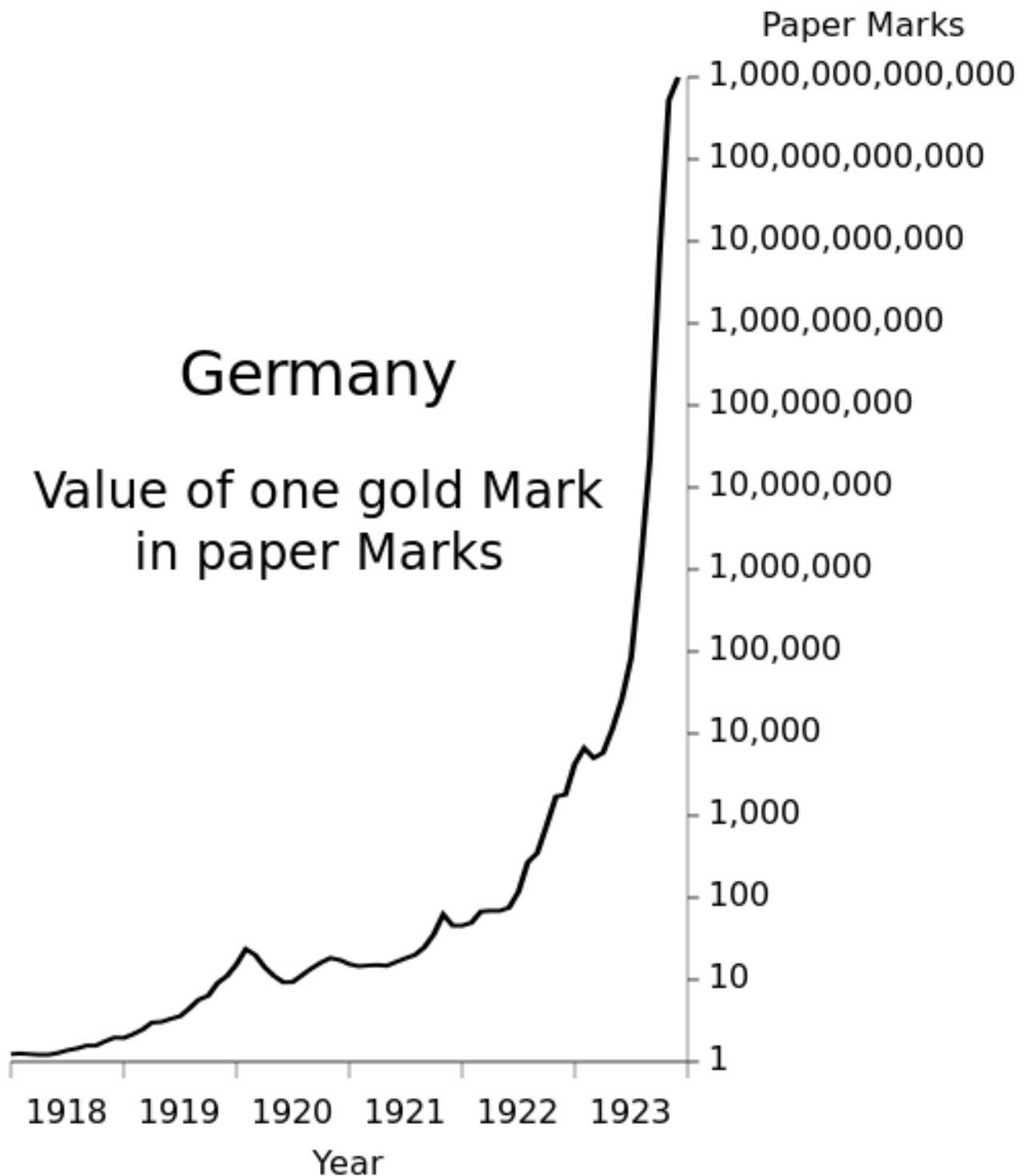
Inflation Begins

At the start of the war the Germans took their currency off the Gold Standard in order to pay for the war. This might allow infinite printing, but it also promised infinite inflation making the German's strategy a double-edged sword. Germany would pay its debt in currency and in goods like coal and iron as the Germany's industry capacity remained intact. However in 1923, Germany couldn't pay back its reparations so the Allies seized German industry like factories in the Ruhr Region to take as payment. Workers were ordered to riot and this put Germany's main industrial complex in chaos. The German's had effectively lost their main source of income and were now forced to print to pay the reparations. This started the rapid decline in the Mark's purchasing power. Soon bank notes like the one shown below started flying off the printing presses.



To Infinity

The graph below shows the extremely rapid loss the purchasing power of the Mark as its value got nearer to zero. Yet even some economist during the hyperinflation said that everything was going to be fine.



Source: Wikipedia

Chaos in Weimar Germany

The situation in Germany quickly spiralled out of control as the Mark become worthless. A loaf of bread costed 163 marks in 1922, 1.5 million marks in September that year and peaked at 200 billion marks for a loaf of bread in November 1923. Prices were rising quicker then people could spend currency and workers were paid hourly and would buy out anything as quickly as possible before their earnings was useless. People brought items with wheelbarrows of money. It was getting to the point the mark became so worthless that people used it as wallpaper and gave it to children to play with. One time a man had his suitcase full of German Marks stolen. The thief left the Marks, but took the suitcase, this is how worthless the Marks were. In the end people had to resort to bartering.

Zero Madness

The Weimar Hyperinflation brought about the condition called Zero Stroke., which is the desire to write endless zeros. The people like clerks and banknote printers suffered from this condition as they had to deal with so many zeros on the German Mark banknotes.

Massive Devaluation

The hyperinflation was fixed in late 1923, when a new monetary system backed by gold was introduced. The new currency was called the Rentenmark. The German's revalued their currency by taking 12 zeros off. This is one way governments steal the wealth of their citizens by devaluing their currencies. The currency devaluations the Russians did throughout the 20th century are a good example on how governments have robbed people of their wealth through revaluation. A revaluation occurs when you have to hand in your \$100 to get \$10 of the new currency. You just lost 90% of your wealth.

Russian Revaluations

Russia throughout the 20th century had many economic problems like the Russian default in 1988 caused by the melt down of Long-Term Capital Management and the Russian Revolution which caused the Russian Government to revalue the Russian Rubble several times. The Russian Rubble was revalued six times in 1922, 1923, 1924, 1947, 1961 and 1998. Overall 5 quadrillion Russian Rubbles in 1922 are needed to get one 1998 Russian Rubble. Mike Maloney in a presentation explains how the *"Russian Rubble was devalued 5 quadrillion times over that time frame. This is the amount of theft that governments can perpetrate on their populations."*¹⁸

1932-1960's: Post Depression

"By a continuing process of inflation, government can confiscate, secretly and unobserved, an important part of the wealth of their citizens."

John Maynard Keynes

The recovery from the Great Depression was very slow and World War Two didn't help. As seen below it took 25 years for the Dow Jones to reach pre-Great Depression levels. The reasons for the long recovery are:

- The severity of the Great Depression.
- World War II hit the economy back into recession before it even managed to recovery.
- Poor fiscal policies after and during the Great Depression.
- The deficit spending done throughout this period, especially during the Great Depression and World War II, kept the economy in recession.



Source: Macro Trends

World War II

World War II might of increased industrial production for the US, but it didn't make the economy recover as seen by the Dow Jones remaining the same during this period. As explained in the chapter "Money" the US got all of Europe's gold during World War I and World War II and this allowed the US Dollar to become the reserve currency and the US could prosper from this.

Peak of Empire

The time period after World War II up to the 1970's was the peak of the US empire. Economist Mike Maloney explains how the US enjoyed its prosperity during this period as their currency was the reserve currency and the US had most of the world's gold. As gold is true money it gave the US most of the world's wealth. Maloney also points out how the US could do deficit spending without its consequences because the US Dollar was the reserve currency, which pegged the price of the Dollar to gold.¹⁹

The US during this time was an exporter instead of an importer as well as a creditor. Both of these are measures of success as the US didn't have a trade deficit and owned the debt of other countries. However now the US is an importer and debtor nation and so is running a trade deficit and building up a mountainous debt both of which bring downs civilisations like the Roman Empire, Spanish Empire and now the US empire.

Real Economic Recovery

The US was able to recover well, because it was a real recovery not a recovery done by purely currency creation. The US people had good incomes, jobs and real manufacturing, real estate and business was being generated.

A Generation of Savers then Spenders

The generation that lived through the Great Depression really now what hard times are and become savers. By the 1960's, the savers had saved up a lot of currency, which would then be spend by their children. All of this new available currency that could be spend was another reason why the economy went well. Many people could afford things they could never afford before. However, all of this spending increased the circulation rate of the currency, which lead to massive inflation and another recession in the late 1970's. Also, the next generation was a generation of spenders and they never knew hard times and weren't very frugal, so this would be a problem for them when they run out cash.

The 1970's and Onto the 80's

The 1970's was the end times of the golden age for the United States. This decade was a time of massive deficit spending, high inflation and high interest rates. The 1970's also saw the change in the world monetary system from a gold standard to a fiat currency.

Pile on the Debt

"We don't have a trillion-dollar debt because we haven't taxed enough; we have a trillion-dollar debt because we spend too much."

Ronald Reagan

In the 1970's the US government was piling up its debt with many new expenditures. These included the Vietnam War (1964-1975), which costed \$111 billion (\$800 billion in today's Dollars). The US also spent a lot of currency on social programs like Johnson's Great Society (1964-65), which involves major increases in government spending to fight poverty. All of these expenditures were done through deficit spending through currency creation and this creates debt that the taxpayers have to pay off. So, these social programs did the opposite to what they were meant to do.

Hats Off to Nixon

From 1969 to 1974 Richard Nixon was president. He imposed wage and price controls in 1971, which as seen in the Great Depression and shown by the Romans distorts the markets and causes ramifications for the economy. Nixon was also the one that put the world onto the Dollar Standard in 1971 and this moment marked the end of the US Dollar. All currencies at this point became fiat currencies doomed to fail and this allowed inflation to sky-rocket through currency creation as nothing was restricting the creation of currency any more. We should all thank Nixon for dooming the world monetary system. Before, fiat currencies experiments were in Petri dishes, but this experiment is done being done globally all thanks to Nixon.

Spending to Kept Up Economic Growth

In Mike Maloney's bonus presentation for the "Death of the Dollar: Update" he discusses the contributions demographics have to society as there are young workers, middle-aged spenders, older savers and old social burdens. He states that *"Our economy is set up so that if our GDP doesn't grow at about 3% per year it doesn't keep up with the required growth of the monetary system."* The size of the working and spending demographic has to increase by 3% each year so there is enough currency in existence to avoid a deflationary collapse. In the 70's, these demographics stagnated and so was one of the main reasons why the 70s was such a bad time.²⁰

Massive Inflation

As seen by the graph below, inflation was very high during the 70s, reaching over 20% in 1974.



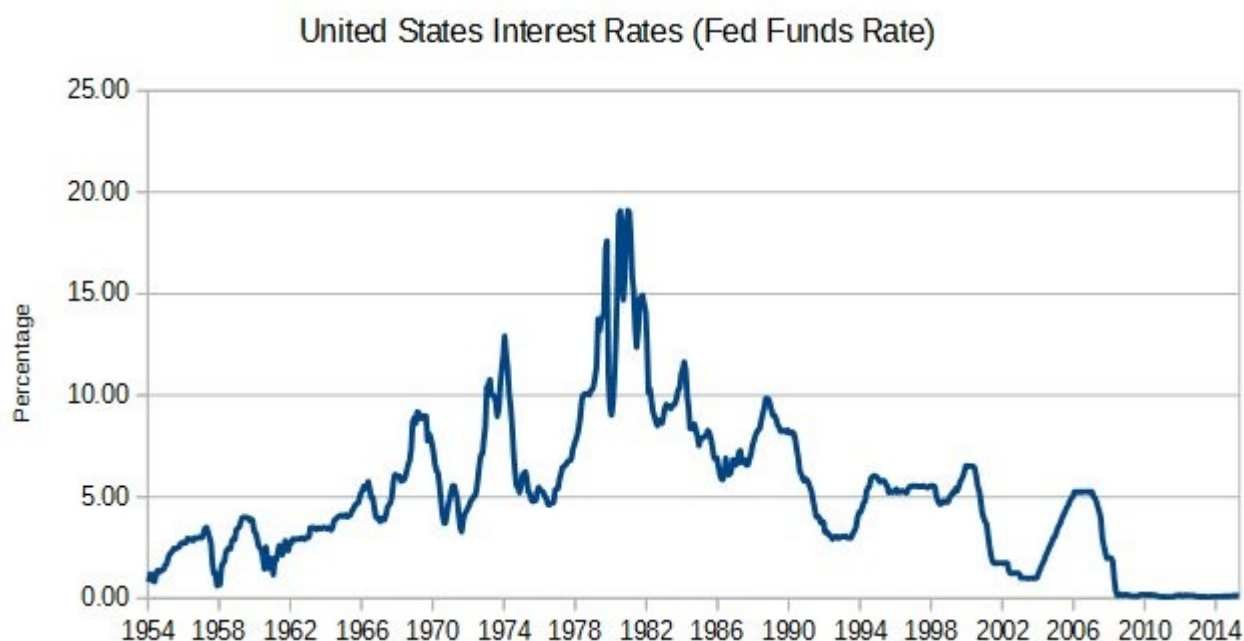
Source: Macro Trends

Cost of Inflation

The inflation caused an economic recession throughout the 70's with many people getting unemployed with the unemployment rate doubling from 5% in 1974 to 10% with a year. Many people panicked at the loss of their wealth due to inflation and the masses fled to precious metals to protect themselves from inflation. Gold was also unpegged and its value soared up to \$850 by 1980 and silver had a similar price soaring at the same time. This was an opportunity for massive gains, which is repeating itself today on a larger scale and the reason for this you will find out later, but what you should know is moments like crisis are opportunities are making massive gains.

Fighting Inflation

High interest rates decrease ability to access credit and this reduces inflation, so the Fed increased its Federal Funds Rate (interest rate) to all new highs. The graph shows how interest rates rose above 10% in 1974 and all the way to up 20% in the early 1980's. However high interest rates cause recessions and stock markets to plunge.



Source: Board of Governors of the Federal Reserve System (US), Effective Federal Funds Rate [FEDFUNDS], retrieved from FRED, Federal Reserve Bank of St. Louis
<https://research.stlouisfed.org/fred2/series/FEDFUNDS/>, November 30, 2015.

Two Recessions

There were two recessions during this time period once in 1974 and again in the early 80s. Both times saw high inflation and high interest rates. These two decades saw the acceleration of the decline of the US Dollar and the turn of the US from a creditor nation to a debtor nation. The US economy would start running mostly of governments bonds and at the start of 1980's, the US debt as a percentage of GDP would be on a continuous upward rise.

The Stock Market

This period of time saw a decline and bottoming of the stock market with the biggest single day crash of 22% in 1987, but the stock market would then go into the biggest bubble it ever had: The Tech Boom.

The Tech Boom

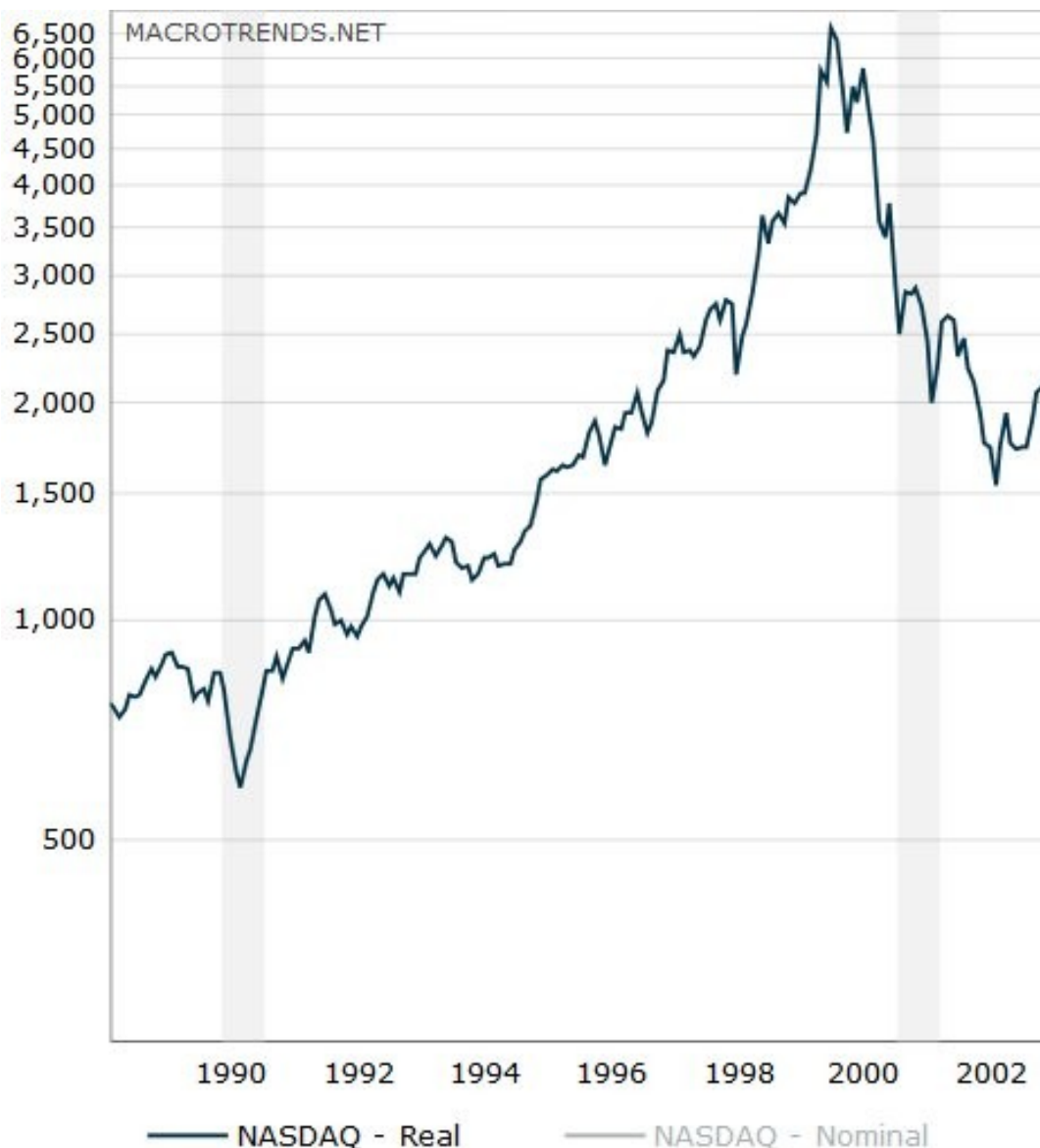
The Tech Boom was the largest bubble ever in the history of the stock market. It was a time of prosperity and everyone thought they could make currency from investing in the stock market. Many thought the stock market would continue rising. However, this was also a time for corporate fraud and failure that was Long-Term Capital Management and Enron.

The Bubble

The graph below is of the NASDAQ, which are technology stocks. The NASDAQ peaked at 6,500 points before taking the long way down. According to Robert Shiller, the average P/E ratio is 16, but the stock was at a P/E ratio of 40 with technology stocks going well beyond 100. The declining of the interest rates also promoted the increase of the stock market and the end of the boom was coupled with Enron filing for bankruptcy.

Lower and Lower

From the 1980s, interest rates were on a decline. By 2000, they reached 7% and interest rates only rose again for a few years during the 2000's, before dropping again all the way to almost 0% during the Financial Crisis.



Source: Macro Trends

The Latin American Crisis

During the 1990's, the countries in South America were enjoying a prosperous moment that was fuelled by people pouring their currency into these countries. Argentina itself was the most prosperous out of the South American nations as Niall Ferguson outlines how *"Investors who flocked to buy Argentine bonds hoped that Argentina would become the United States of America"*¹³.

Debt Fuelled Prosperity

The prosperity these South American nations were enjoying was due to the deficit spending the governments of these countries were doing. Their massive spending habits lead to a rapidly increasing debt. When this debt got too big, inflation starting soaring in these countries and this lead to the Latin American Crisis.

The Latin American Crisis

Many countries like Mexico, Brazil and Argentina in South America experienced economic crises that was called the Latin American Crisis. Mexico in 1994 had its currency's value reduced in order to increase the value of their exports in order to solve their economic problems. This is around the start of the currency wars that plague us today. Argentina was hit very hard by the crisis with their country getting to experience hyperinflation.

The Argentine Hyperinflation

Argentina's economy before the Latin American Crisis had been almost as strong as that of the United States, but Argentina was left poor after this crisis and still remains poor. Argentina had been in two wars: a civil war in the 1970's and a war against Britain over the Falkland Islands in 1982, which Argentina lost. This lead to the Argentine Hyperinflation in 1989. The Argentine Government tried to print its way out of debt in 1989, which accelerated the inflation rate. In February 1989, inflation was 10% per month with the austral falling 40% against the US Dollar on February 7, which is known as Black Tuesday. Social unrest increased, banks closed and the printing of currency accelerated with annual inflation going up to 12,000%. The inflation eventually become hyperinflation and it took years before things settled down.

Ferguson in the Ascent of Money shows us how quickly the austral lost its purchasing power with an annual inflation of 12,000%. He states that *"If you wanted to go out for dinner in Buenos Aires on a Saturday night, in May you'd pay 10,000 australes. By June you'd have to pay 20,000 for the same meal. And by the following month, it would take 60,000."*¹³

Long-Term Capital Management

This was a hedge fund founded in 1994 in Greenwich. Long-Term itself was a business that did highly leveraged investments. Leverage involves borrowing for an investment. Long-Term's idea was that their trading practices will offer a return and that risk was near to zero. However Long-Term failed in 1998 due to a global wave of crises. The owners of Long-Term miscalculated and didn't see this as possible.

A New Idea

Myron Scholes and Robert Merton (developers) of Long-Term had found a new way to price the form of derivative called an option. An option is a type of contract that allows you to buy something at today's price in the future and if the price of that item has increased by "x" then you make a profit of "x", but if the price of that item dropped however, then you don't have to carry through with the option and only pay the price of the option itself. Scholes and Merton came up with a complex revolutionary formula on how to price an option taking into the account the fluctuation of the price of that item. Scholes and Merton would use this concept in Long-Term and they made currency out of it by having people not knowing on how to price options so they could end up buying something up at a much lower value then it should be.

Making Megabucks

Nail Ferguson explains how *"Long Term Capital Management, made megabucks by selling options that were never exercised because the buyers had guessed wrong and Long Term got it right. They also made a killing by buying up all kinds of different securities that the rocket scientists thought were mispriced."*¹³

Gearing

Long-Term had got most of its capital through gearing, which is using debt to make an investment. Long-Term was extremely highly geared and they thought that this wasn't an issue according to their formula, which showed that the risk is almost zero with Long Term also having many different investments and trading strategies. Their reasoning was that only a few of these investments could fail, but not all. However Merton and Scholes were in for a big surprise.

A Chain Reaction

Pegging a currency to another is a very bad idea as it builds up energy and when released, sends devastating shock waves around the world. This was the case in 1997, when Thailand unpegged the Thai baht from the US Dollar. This resulted in Thailand going into economic turmoil, which ended up causing the 1997 Asian financial crisis. This started a chain reaction around the world with the 1998 Russian Financial Crisis and Default, which then led to the meltdown of Long Term Capital Management. Merton and Scholes thought of the world as a predictable place, but the world is far from this where humans act like cattle in financial markets; one gets scared, then the rest get scared.

They Got It Wrong

The risk models used by Long Term only used 5 years of data and didn't include any crashes. If they used more data and included stock market crashes, their risk models would be much different.

Near Economic Collapse

The collapses in 1998, caused Long Term's capital holdings to plummet in value over 1998 with it losing \$1.85 billion, which is 45% of its net worth, in August after the Russian Default. Long-Term was on the verge of failure, but Long Term would be bailed out as the collapse of the hedge fund was causing the global financial system to shut down. The financial system got within hours of stopping before Long Term got bailed out by various banks and governments, which should the system from collapsing. The bail-out totalled \$4.6 billion and this goes to show that no one can know everything about the economy and be able to predict it.

Enron

"What John Law's Mississippi Company had been to the bubble that launched the 18th century, so another company would be to the bubble that ended the 20th. It was a company that promised its investors wealth beyond the dreams of avarice. It was a company that claimed to have reinvented the entire financial system. And it was a company that used its impeccable political connections to ride all the way to the top of the bull market...that company was...Enron"

Niall Ferguson - "The Ascent of Money"

Enron was a company that used many unethical business practices to make profits and look profitable such as hiding debt off balance sheets and using derivatives in a new way. Many of these practices are the reason why the 2008 Financial Crisis occurred and why our economy is also currently in turmoil.

The Smartest Guys in the Room

The documentary "The Smartest Guys in the Room" discusses how Ken Lay, who is the chairman, used fraud to turn Enron into the biggest energy company and make massive profits from the company.

Deregulating

For Lay's strategy to work he had to have the energy industry deregulated. By helping George Bush become president, Lay got his wish as Bush deregulated the energy industry to return the favour. This allowed Enron to take control of many energy assets including most of the gas pipelines in the world in the late 1990's. However the income from these assets wasn't enough and so Lay got Enron involved in many scandals like derivatives. Enron seemed to be doing so well, despite it wasn't. The graph to the left shows Enron's share price.

"Derivatives are financial weapons of mass destruction."

Warren Buffett

Derivatives

Derivatives are a fairly new form of financial instrument that were developed first as hedge funds to manage risk in the agricultural industry. A derivative is a paper asset that comes from an underlying asset such as a \$100 derivative being backed by \$100 of silver. There are many different forms of derivatives like future contracts and options so each form of derivative was established at different times.

Origin of Derivatives

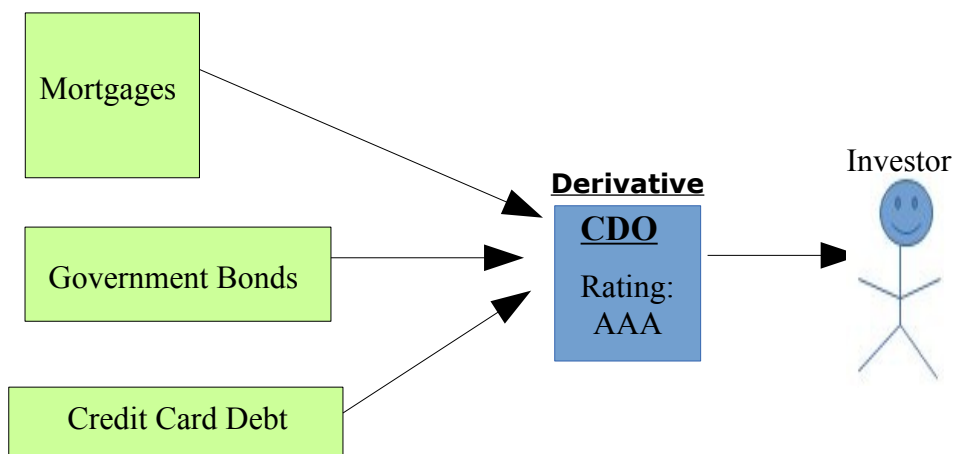
Derivatives in the form of future contracts were established to protect farmers from changes in prices as *"A future's contract allows him to protect himself by committing a merchant to buy the crop when its brought to market at a price agreed when the seeds are being planted."*¹³ as explained by Niall Ferguson. This works with any asset. A buyer has agreed to a seller to buy gold for \$100, which is today's price within a year even if the price of gold changes. Options would then be developed latter on.

The Downside of Derivatives

There is a real danger of derivatives, which become apparent when Enron used them. Derivatives are still backed by an asset when created, but lose that backing when traded away and so in theory an infinite number of derivatives can be made, which has created a massive derivative bubble today with the total value of derivatives being several times larger than the world GDP. Enron could make currency by selling multiple derivatives of a single asset and this problem of derivatives has resulted in more paper forms of an asset than physical forms. There is more paper gold than physical gold today and in September 2015 for each ounce of registered gold there are over 200 people with future contracts holding claim to it. This type of situation is just unsustainable.

Turning Garbage into Gold

Derivatives came from any assets even the worst of all assets: debt! After Enron, bankers decided to turn debt into derivatives and trade and gamble with it. This process is shown in the diagram below. The banks get together all different forms of debt like government debt, credit card debt and mortgages and turn them into derivatives to sell off to investors. Yet, there is a catch. They call these derivatives Collateralized Debt Obligations (CDOs) and sell them as AAA, diversified investments. These are not AAA or diversified, but garbage being turned into gold.



If that diagram above didn't make it simple enough, then this following diagram will clarify what the bankers are doing with debt.



These forms of "garbage" make up a large part of derivatives and investments and were partly the reason why the 2008 Financial Crisis occurred. Bankers even gamble with it and end up making millions with it. Our current financial system has several quadrillion dollars of derivatives in existence and if the derivatives market blows up...words don't describe.

The Enron Scandal

Enron was actually in trouble for most of its existence, but this was covered up. Enron hid its debt in other companies they owned and claimed its revenues to be much larger than they really were. Enron had to use more forgery in its balance sheet as the situation worsened. Enron traded and gambled in energy, internet bandwidth and even the weather and Enron would sell their own assets off as derivatives. This made Enron and the people running the company very rich. The traders of Enron were very skilled, but things started taking a turn for the worse for Enron as these practices themselves failed.

Everyone is Happy

For Enron to be able to get away with its scandal they needed to keep people involved in it silent. Enron used banks for transactions and rating agencies to make their investments triple A rated and these people were kept silent because they got a share of the profits made from the scam. So, everyone was happy to let it happen.

The Truth Revealed

In late 2000, the truth about Enron's scandal was slowly coming out and their share price started plummeting in 2001. By mid 2001, Enron's share price had dropped from 90 to 40 and Enron in December 2001 filed for bankruptcy. Enron had claimed its long term debt was \$11 billion, but this figure was actually \$38 billion. Ken Lay and Jeffrey Skilling were both tried and then found guilty of fraud and then given very heavy sentences.. Many people were shocked when the truth about Enron came to light and other businesses after Enron would also do similar practices that involved hiding their debt of the balance sheet. Enron was another example of stock market bubbles and should come as a warning to what unethical business actions and derivatives can cause.

The 2008 Financial Crisis

"There are two main drivers of asset class returns – inflation and growth."

Ray Dalio

The 2000s was seen as an economic boom with all assets rising in value. However this asset price growth came not only from growth, but also from inflation as currency creation really started ramping up after 2000. The rise of prices across the board was the effect from all this fresh currency flowing into circulation. However, there still was a boom occurring, mainly in the housing sector. Normally credit follows between assets so one has to drop while the other goes up, however the creation of new currency allowed all assets to go up as this new currency flowed into these asset groups.

The 2000's Boom

Many assets did rise in value during this time with gold outperforming most of the other assets. This boom was mainly in the housing market, where house prices worldwide rose, which also helped drive China's urban boom. This time also saw an increase of interest rates again after decades of them being lowered, but this contributed to the ending of the boom in 2008.

The Housing Fiasco

In 2008 came the popping of the American housing bubble that triggered the Financial Crisis. Yet, the way the housing market was rigged to blow, it wasn't surprising this happened. The way the US government made access to housing to people so easy was the major factor in causing the bubble. Under Fannie Mae and Freddie Mac and subprime loans nearly anyone could get loans. Many who shouldn't even be given a loan. The US developed the NINJA loan: No income, no job, no assets. The name speaks for itself. People who would of never been able to pay off a mortgage were still given out a loan; talk about playing with fire. This was a disaster just waiting to happen; it just needed a trigger and that trigger came in the rising of interest rates.

The Interest Rate Hike

Remember how the effect of interest rates on debt was discussed in the last chapter, "People could barely afford their loans and an increase in interest rates resulted in them not being able to pay back their debts." This was about how the rising of interest rates caused the crash of the housing boom. People on NINJA loans by definition would have it hard trying to make debt payments, but a rise in interest rates made repayment impossible. Economist Niall Ferguson points out how these NINJA loans were more exposed to interest rate fluctuations as "mortgages are for shorter and shorter durations and more and more borrowers are opting for interest-only mortgages."¹³ The rising of interest rates during the 2000's caused more and more home owners to default on their debts until the housing bubble couldn't go on any more in late 2008.

Selling of Trash

As Niall Ferguson explains, "*Sub-prime lenders immediately sold the loans on to banks... and the banks then securitized the loans, which means they bundled them together and then sliced and diced them, so that at least the top tier could be classified as triple-A-rated, "investment grade" securities.*"¹³ The banks are doing what was discussed in the last section, they turned garbage aka debt into gold and then sold them off.

The Crash Arrives

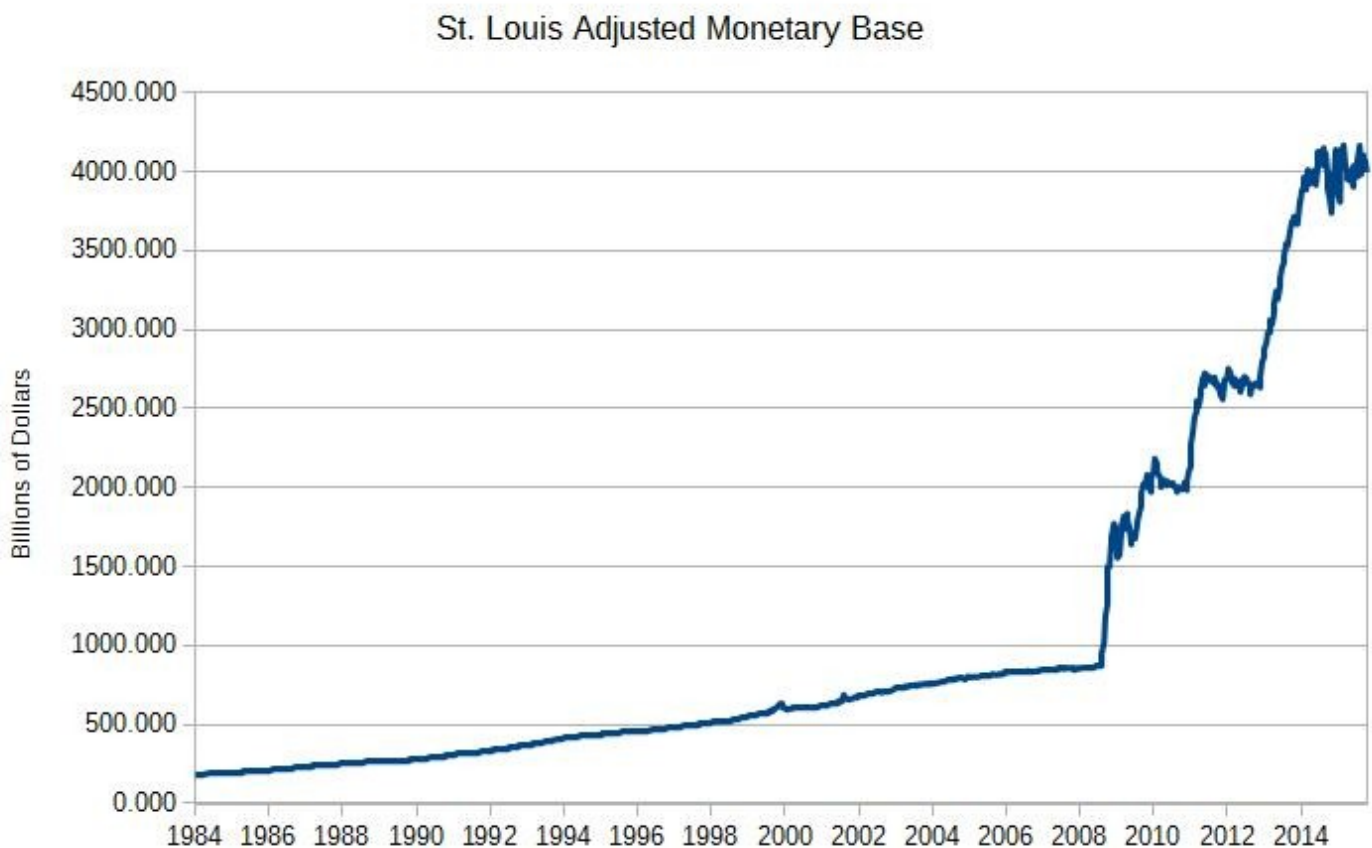
Already by 2006, home prices, employment and mortgage rates were lowering, especially in Detroit. This spread to other cities and more people ended up defaulting on their debts and this caused a secondary effect on the collapsing of the derivative market on these loans. This led to cracks forming in the financial markets with more problems occurring faster as the crisis unfolded. By early 2008, huge companies like countrywide Financial Corp were facing massive losses due to the sub-prime crisis. As 2008 drew to a close the crisis was in full swing as housing and share prices plummeted and unemployment rates rising.

Trying to Fight off Disaster

To avoid an economic collapse governments printed trillions of dollars to keep the economy going. The US and many most other countries lowered interest rates to almost zero and trillions of dollars of bail-outs were given to bankrupt companies like Lehman Brothers, Fannie Mae and Freddie Mac. Billions of dollars were almost pumped into the falling stock markets to make them go up again. The way problems get fixed is by a few people coming up with a solution in a small room and then implementing it and the public doesn't know about it until after it happened as Mike Maloney once said, "*When Lehman Brothers melted down did you find out about it before it happened or it you find out about it after the Federal Reserve and secretary of the treasury and everybody got together and came up with a solution and it was already dissolved.*"¹⁸

A Fake Recovery

The recovery in 2008 was just “kicking the can down the road”, it was a fake recovery. If the economy had recovered then, government policies such as crazy currency creation and low interest rates would have ceased and the economy would have actually recovered not stagnated. The unemployment rates have remained high, interest rates are still low and the QE schemes are repeated, ad nauseam, as they keep failing. Below is a chart that was presented in the last chapter, which displays base currency of the US Dollar. The amount of dollars the US is printing just boggles the mind. If QE1 had worked then the US wouldn't of done QE2 and QE3. This insane creation of US\$3.2 trillion wouldn't be happening if everything is fine and now there is talk of QE4.



Source: Federal Reserve Bank of St. Louis, St. Louis Adjusted Monetary Base [BASE], retrieved from FRED, Federal Reserve Bank of St. Louis <https://research.stlouisfed.org/fred2/series/BASE/>, November 28, 2015.

The Stock Market supported by QE

The stock market is only rising when currency is created and pumped into it as each time QE stops the stock market drops. This realisation has come to light as of the recent events of stock market crashes occurring due to a lack of QE (see graph below). Another fascinating thing is that the majority of companies' share prices are declining. The stock market is being pushed up by printed currency being used to push up the share price of a few companies like Apple.



Source: Macro Trends

Recent Events and Future Outlook

We are approaching an uncertain future and the best we can do is to position ourselves right in order to be ready for a possible crash or in the best scenario profit from it. The next chapter will look at our recent history, current events and the possible future scenarios that will play out. After that chapter we will then look at how to financially position yourself in order to face the uncertain future feeling at ease that your wealth is protected in the event of a possible economic collapse.

History as Now

Currently governments have decided to “kick the can down the road” and continue on the path by attempting the fake recovery from the 2008 Financial Crisis. The world economy has totally changed since then with the Federal Reserve increasing the monetary base of the US dollar at insane rates and countries going into negative territory with interest rates. This chapter will discuss historical events that have occurred after 2008 and the current events taking place and how these events can unfold in the future. Currently, the US and Europe are on “Mount Debt”, China is going into recession and taking Australia with it, Greece is in shambles and there has been a massive deflation in certain commodities like iron ore and gas. What does the future hold?

Propaganda

Statistics will become suspect to propaganda. Economic figures like GDP and unemployment would be altered to make the economic conditions seem better than they are.

Given No Choice

It's not like the government just wants to use propaganda. They are forced to by the public as if the government did reveal the truth, there would be panic. Once a person in China was attacked by panicked crowds as the stock market plunged. This censorship of information might protect society by maintaining order, but it's not really ethical, as it hides the truth from the public.

War

War is used by many countries as a distraction or a means to profit from. The United States has been able to profit from war when they obtained gold in World War I and World War II and when the US military arms and consumer goods are sold off to other nations that are at war. The US has also been at war for most of the nation's existence.

Mainstream and Alternative Media

Most people follow the mainstream media like the news on TV, government statistics, Sydney Morning Herald, Bloomberg and New York Times. However these media sites often ignore or give little coverage of important issues like high US unemployment and these sites can be controlled by large companies so what news the public gets from these sources is controlled and filtered. Alternative media sources like Youtube and certain websites like ShadowStatistics don't have these potential problems that mainstream media has. Alternative media generally comes from people in the middle-class and they offer the more “accurate” information like David Quintieri does for his Youtube channel, his goal is about distributing more accurate information among the masses.

The Decline of the American Empire

The United States has been the world power for a long time, but this is changing. The Chinese economy is shown to overtake the US economy in terms of size as all the production, wealth and jobs are being outsourced to China. The US however, especially the Federal Reserve still plays a major role in the world as the world's central bank.

A New reserve Currency

The US have prospered because their currency was the reserve currency as Mike Maloney explains it "The US Dollar Standard gave us *"The US" an advantage over every country on the planet and for last two decades our politicians have been abusing this privilege as if it was a birth right.*"²¹ and now the US are receiving the punishment for it. This punishment is that countries are moving away from the US Dollar to the Chinese Yuan and this movement will be the death-knell of the US economy. There are several possible new monetary systems we can end up with such as Bit-Coin or a one-world currency, but the Chinese Yuan is the most promising. As of late 2015, the IMF included the Chinese Yuan into its basket of elite currencies that include the US Dollar and the Euro.

The Fed and Interest Rates

The Federal Reserve for the moment is the defacto world's central bank. Its opinions effect the world and no branch of the US government can tell the Fed what it can do. The current talk has been whether or not the Federal Reserve to raise interest rates. The Fed had recently in September decided to hold off the interest rate hike as they have been doing for years, as mentioned in a CNBC article from 2012, which states that the *"Fed's current monetary policy is unsustainable beyond the U.S. Election"* as said by David Goerz.²² This article highlights that the interest rates had to be raised in 2012, but now it's 2015.

The Federal Reserve on December 17, 2015, had made a historical moment. They have raised interest rates by 0.25% for the first time in 9 years and despite this being such a small amount, it still caused a big impact. Despite the dangers of this interest rate hike, the Fed decided to do it to maintain their reputation as many have been expecting this for a long time. The Fed can't raise the rates much higher and might even be forced to lower the rates back down again due to the current economic conditions. This interest rate hike will just quicken the demise of the US economy as the government and other debtors will have to pay more interest on their debt now.

Many organisations have throughout 2015 warned about the dangers of rising interest rates. Back in September, David Woo from the Bank of America stated that *"a September hike would be a mistake"*²³ and the Fed decided to delay the interest rate hike due to the *"global economic weakness and financial market turmoil"*²⁴ So, we can conclude that the Fed will have to lower the interest rates again or face an economic depression.

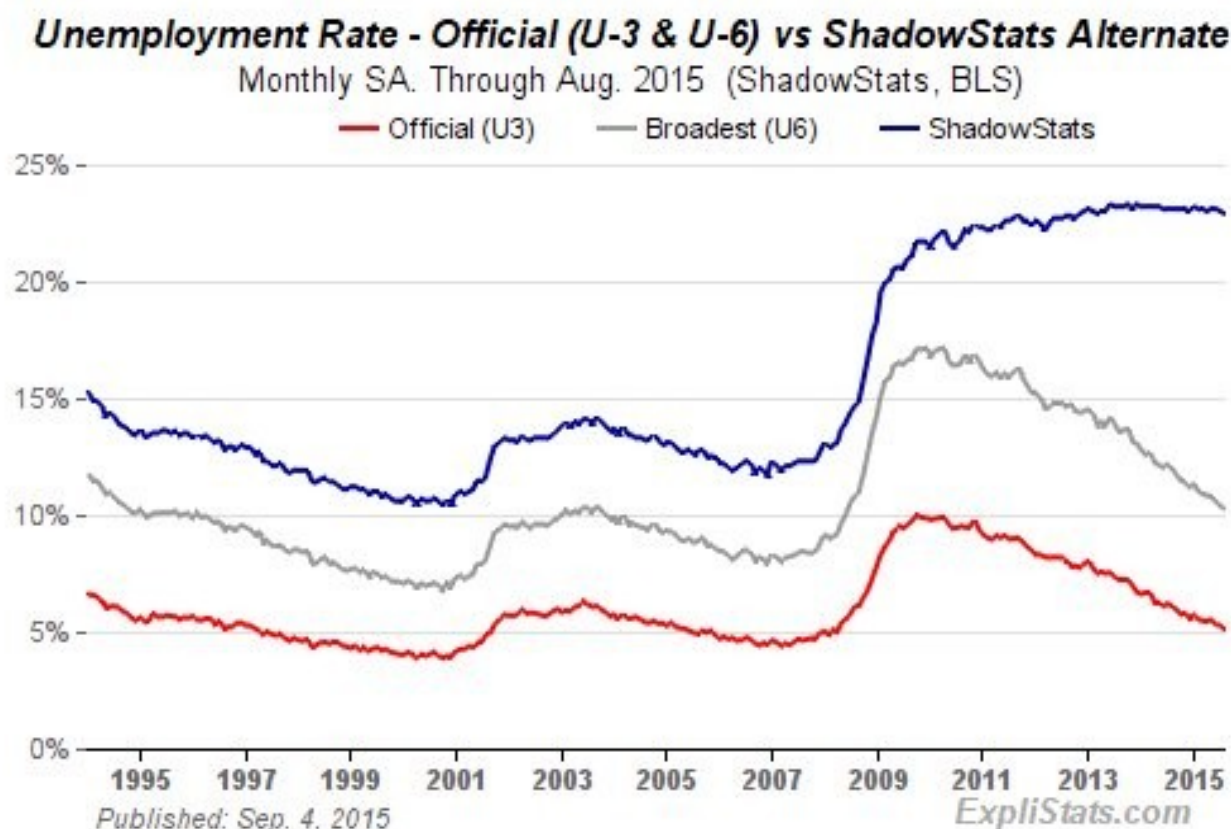
Another Round of QE

There is also recent talk about if the Fed will do another round of QE in wake of the recent plunges in the stock market that was called Black Monday. On August 24, 2015, the Shanghai Index fell by 8.49% and this day is being called Black Monday, where stock markets world wide took a plunge before continuing a steady fall. This fall in stocks is creating talk and pressure for another round of QE, which would probably take place. When a government says they won't do something like impose capital controls, they will most likely impose capital controls and so we can be certain that the Fed will do QE4 just like the Greek government agreed to the 3rd bailout terms when they said that they wouldn't. Rick Rue in a recent discussion with Mick Maloney in October revealed that the US president is planning for QE4.²¹

Unemployment in the US

David Quintieri on October 3, 2015, did a video on how the government lists unemployment rates at around 5% despite a multi-decade low participation rate of 62.4%. The participation rate shows the people who are employed or looking for work. This means that out of the 319 million Americans, 95 million of them are not looking for work or employed. These two statistics contradict each other and considering the conditions in America right now, there is no way that the unemployment is truly 4%.²⁵

As the official government unemployment rate doesn't include underemployed people (Refer to Unemployment Rates in the Fundamentals of Economics chapter) it's lower than it should be. In the graph below, the U3 and U6 are the government's different measures of unemployment. ShadowStats constructs the blue line by including the underemployed people. Since the financial crisis there is a growing divergence between the blue line and other two lines showing an increasing inaccuracy of government unemployment statistics.



Source: Shadow Stats

The only jobs in the US are low-waged jobs and all good jobs are disappearing. All the businesses and the jobs they provide are outsourcing to places like China due to all the American laws and regulations that hinder these businesses and their profits. It's just easier to make profit in developing countries than in the Western world. This is also the case with Australia as businesses move out of Australia in sectors like manufacturing.

China's Boom comes to an End

As previously discussed China is coming out of its boom and is heading into recession. Despite this, China will fare much better than the US as China is a creditor nation and has actual growth. Wealth and jobs are flowing into China, who are also buying up lots of gold. This means China will be able to recover from this economic crisis much better than the US. Other countries like Germany and Australia will also endure the crisis far better than most other countries, the reasons for which will be discussed later.

Shanghai Index takes a Plunge

In the chapter "[Fundamentals of Economics](#)" the relationship between China and the US was looked at and we saw how the Chinese economy was sinking along with the Shanghai Index falling from 5,000,000 points in June to 3,000,000 within four months. We haven't seen a drop that large since the Financial Crisis, as indicated by the graph from Trading Economics below. This took many other stock markets along with it down and caused the economic conditions in China to worsen. China more openly does QE than the US and their QE programs have been ramping up with no success. China recently saw their stock market recover slightly and this can be a sign that China might have intensified their QE program.

SHANGHAI COMPOSITE INDEX



Chinese Currency Wars

China has been engaging in currency wars and has been de-valuing the Yuan and been selling off US debt as previously discussed. China has been doing this due to the fall in their stock market and they lower the value of the Yuan to sell exports cheaper and this hurts the purchasing power of the Chinese population.

Chinese People flee China

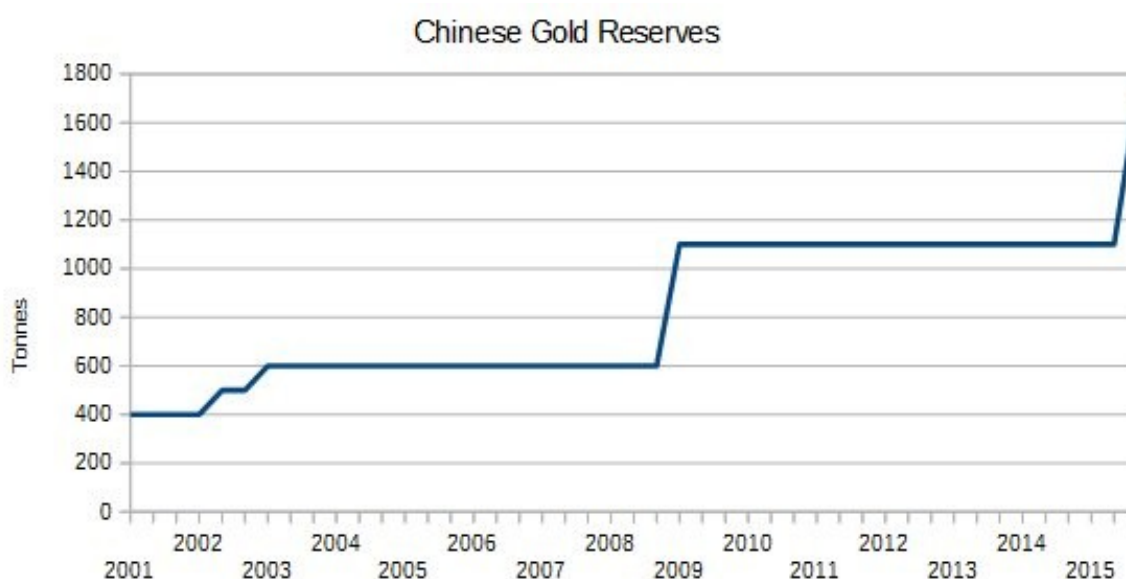
The currency wars had resulted in many Chinese people fleeing China and getting their wealth out of China. The Chinese people want to get their currency out before it loses more of its value from the currency wars. According to the Hollywood Reporter, a large number of China's upper class citizens are fleeing the country and are on a "*spending spree*".²⁶ The boom in China had made a number of very rich Chinese people, who are now buying up large tracks of land overseas, fuelling the Australian housing bubble.

Capital Controls

China has imposed several capital controls on capital flow in the stock market and in and out of China. The result of people fleeing from the Yuan has resulted in the Chinese government imposing capital controls on how much Yuan can leave the country. The amount of Yuan Chinese people can take out of China is being restricted more and more as the year goes on. The fall of the Chinese stock market has resulted in China putting capital controls on the stock market. People in certain cases can't take their currency out of the stock market or if they do, they are often criminalised.

Chinese Gold Fever

China in the last few years have been selling off US debt and buying up gold. Many countries are diversifying their reserves by buying up gold and China has been doing this on a much larger scale. China's gold holdings, as shown in the graph below, have been increasing rapidly with China being in the top ten countries in total gold reserves held. This large ownership of gold will mean that a lot of the world's wealth will go to China when the fiat currencies become worthless.



Source: WWW.TRADINGECONOMICS.COM | WORLD GOLD COUNCIL

Everyone joins into the Gold Rush

Many countries around the world are also trying to buy up gold and get it back. The US have been holding lots of the gold held by many countries and have to return these holdings now. The US is said to have most of the world's gold, but what seems to be the case is that they have much less gold than what they claim to have. Most of the gold in the US is owned by other countries like Germany, who had been having difficulty in getting their gold back, which brings up the issue that the US doesn't have all the gold they claim to have in reserve.

Australia's Recession

The Bigger Picture

The economic situation of Australia will be of far more important to the majority of these readers and so this book will now take an extensive view on Australia. Australia overall will do better than most nations. Countries in Europe, excluding Germany, and particularly the US, where the problem is large, will be far worse off. Japan with its inflated currency and largest debt in comparison to GDP out of all countries won't far well either and Australia has a small debt in contrast to these other nations. Japan, Italy, the US and other countries with aging populations are at a disadvantage, while Australia's population is not as aged and the populations of developing nations are full of young workers. The factors that determine a nation's economic success are its demographics, economic freedom, debt size, fiscal policies, economic growth that is real or fake and the natural resources of that country.

The Housing Bubble

While other nations like the US had their housing bubble "pop" in the 2008 Financial Crisis, the bubbles of Canada, the UK and Australia lingered before soaring upwards again. Australia's housing bubble is unique in the sense that the bubble is in only select areas. In the major cities, the prices are soaring, especially in Sydney, which is where the bubble is biggest. In Sydney the median house price has exceeded \$1 million in July 2015 which is 9 times the average income in Sydney. The other major cities also have high house price to income ratios. In more rural areas, there still is a bubble with houses being priced at around \$500,000, but certain areas have had their housing prices drop due to the ending of the Australian Mining Boom. The price of housing in mining towns has declined, but Australia nationally is in a housing bubble. In the Coffs Harbour region the median house price is \$405,000, which is 7 times the average household income there, which is classified as a bubble. Normal house price to income ratios would be around 2-4 and 1 for undervalued houses.

In Sydney the rising of house prices have sky-rocketed in last two years. A World Socialist Web Site article states how *"house prices in Sydney grew by almost 23%, year-on-year to June, 2015."* and that is far above the national annual increase of 10%. From 2010 to 2013, the price had levelled off, but after 2013, the price starting going up again and at a faster rate than before 2008. The article goes on to tell how these prices are *"now more than 17 times average earnings"*. The scale of this bubble in Sydney can be expressed by how the house prices in Sydney are higher than London meaning Sydney is near the top world wide, when it comes to house prices.²⁷

Factors Contributing to Sustaining the Bubble

There are a number of factors that contribute to sustaining the bubble, which also can lead to its end. Firstly, for a bubble to be maintained it will need new buyers to push up the price, but higher prices will eventually dry up the amount of buyers available. To make buying easier, the Reserve Bank of Australia has lowered interest rates all the way down to 2%, which have to keep being lowered to sustain the boom. Another factor is that rich Chinese investors are buying lots of Australian real estate and if interest rates rise or these buyers stop then the bubble will go pop. Just by the Australian economy sliding into recession as a result of the Mining Boom ending can cause the bubble to pop as a chain reaction.

The Australian Mining Boom

Australia came out of the 2008 Financial Crisis strong, while many economies slumped, Australia went into the Mining Boom. This boom kept the Australian economy out of recession until 2013, when the boom ceased and Australia joined the worldwide recession.

All About China

The boom in China had led to a massive increase in the demand for raw materials like iron ore and coal, which Australia had. Australia was a mining country and they became the main supplier of these materials for China and Australia was lucky that China chose them, as other countries like India also had these resources.

Time of Prosperity

During the boom, the Australian economy prospered brought on by the new wealth flowing into the economy from the mining sector. The boom had altogether created better living standards, new jobs and new mining towns in Australia. In 2001, there were 15,000 people employed in coal mining and this number jumped to 60,000 by 2014 and disposable income had increased by 13%. The boom had brought on a high appreciation of the Australian Dollar and two thirds of Australian exports became raw materials. This however created a dependency on China and the decline in the Chinese economy signalled the end of the boom in 2013.

Saturation of the Market

The main reason for the decline of the Mining Boom was the slowdown in China. The way urban development in China was ahead of urban migration shows how China was outdoing itself. The demand for commodities like coal that resulted in a rapid rise in their prices was slowly vanishing since 2012 (peak of the boom) and the prices then went into free fall. The price of coal dropped from \$180 in 2010 to \$60 by 2015.

While demand was dropping, supply was still rising. Australian companies like BHP wanted to increase output and productivity to offset the decline in prices of raw materials and make a profit, yet this failed and it saturated the market further. The fall in demand and rise in supply led to a double whammy on the prices of raw materials and this would have massive consequences for Australia. The decrease of revenue from the mining sector made many mining towns and businesses suffer and led to the loss of many Australian jobs.

Bad Times Ahead

Many mining towns went into economic crisis as mines foreclosed, jobs were cut, investments became stalled, business dried up and many businesses closed. A lot of people were faced with the trauma of having lost their job and had to find a new way of earning a living such as Peter Windle, who had been a manager at Glennies Creek Coal Mine in NSW, but now is a bus driver. Many other mining towns faced the same story and people that stayed were faced with little income, but high inflation. This problem also affected the economy as a whole. The government had lost a large chunk of its revenues and the Australian GDP took a plunge.

The Australian Dollar

The Mining Boom had brought on high appreciation of the Australian Dollar as shown below with the Australian Dollar rising from 0.6-0.8 against the US Dollar to over 1.0 against the US Dollar in 2011 during the peak of the boom. The high appreciation caused Australian exports to become pricey and hard to sell and imports to become cheaper. This ramification of the high Australian Dollar involved the punishing of exporters in any non-mining sector. They found it harder to sell their products and this included the agriculture industry. The manufacturing industry, despite being an exporter wasn't as badly hit due to its link to the mining sector. Manufacturing was hypothesised to have been 5% better without the Mining Boom. The end of the boom had resulted in a severe drop in the Australian Dollar to almost Financial Crisis lows.



SOURCE: WWW.TRADINGECONOMICS.COM | OTC INTERBANK

Pointing Fingers

The Australian government was blamed by some for not regulating the supply made by Australian companies during the boom and if it had been controlled then an oversupply might not have happened. This finger pointing for current economic problems is being done by the US too. The US are blaming China, who then blame the US in return. Yet, they all are at fault.

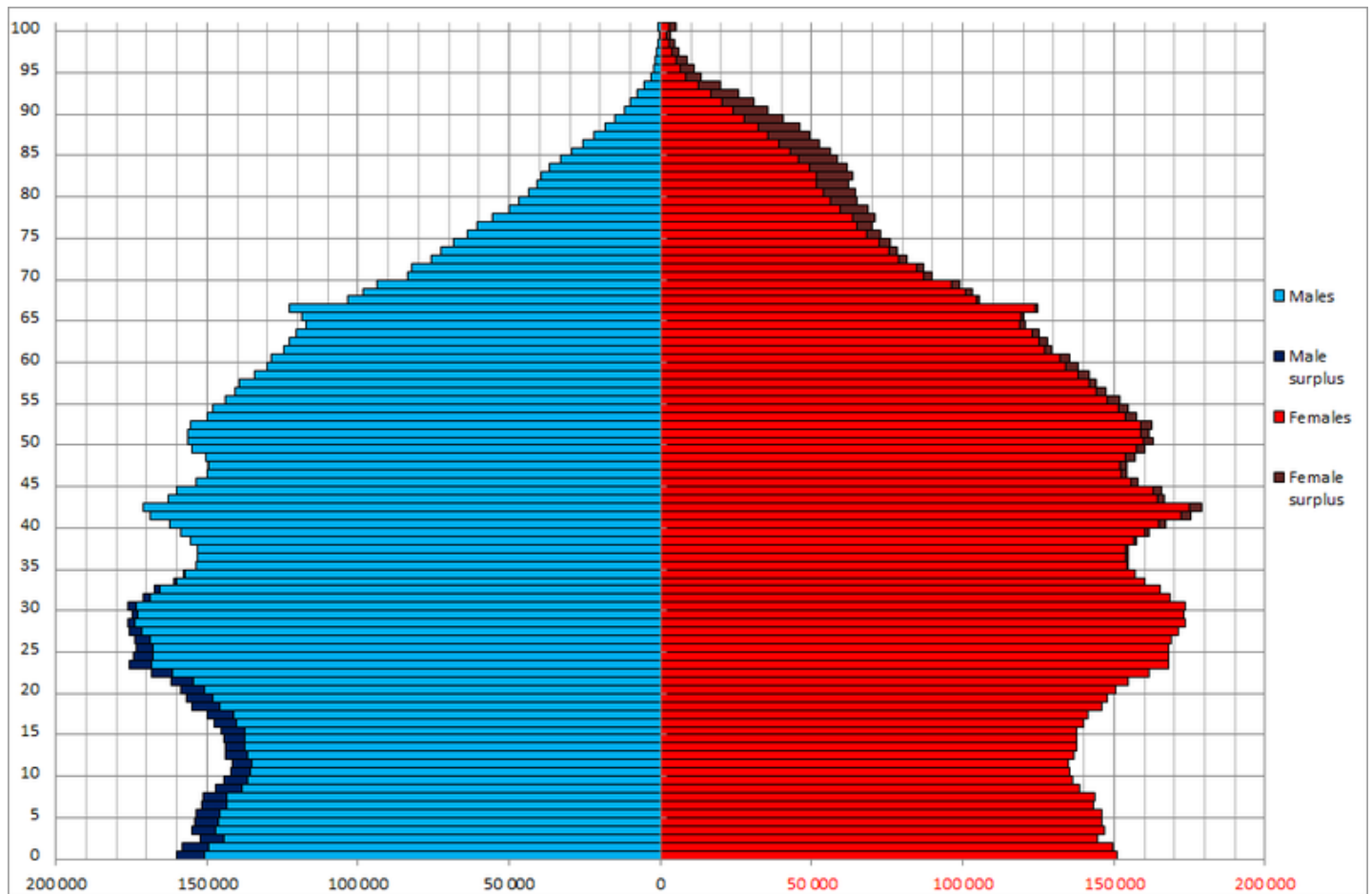
Dependency on China

Australia's fate is intertwined with China's. Ever since the mining boom, exports to China had made up a large portion of Australian exports and so where China goes, Australia goes too and China is going down. This recession in China can cause another severe drop in Australian exports going to China and this is the making of a severe economic issue for Australia as it can be the pin that will pop the Housing Bubble in Australia. Mike Maloney states how *"A third of your exports going to one place is something that is very out of balance."* and since China is heading into a big recession, Australia will also slide into recession.²⁸ The effect China has on Australia was very obvious during the Mining Boom.

Good Demographics

Australia as stated before has good demographics in comparison to other countries, which is their main advantage. The large amount of young people in Australia as seen in the demographics below will help drive the economy and these people will be able to support the older generations. In the US and Japan there is a far greater number of older people and this isn't as evident in Australia yet. Mike Maloney says *"Overall, Australia and New Zealand, these areas are very good places to live because of demographics."* as there are a lot of young people in the Australian population.²⁸

Australian Demographics (2013)



Source: Wikipedia (author: Rickkly1409)

Inflation

According to government statistics, inflation in Australia is hovering around 2%; but the rising of prices in everyday goods and services just don't add up to meet this figure. An article from Money Morning from 2012 by Shae Russell puts up the fact that Australian inflation statistics are not accurate. Considering that true inflation for the US would be 10% instead of the 1% they claim, Australian inflation should also be much higher. She explains how the inflation calculation method in the US and Australia has changed to a substitution-based method, which leads to lower inflation figures. This along with the fact that prices for things like electricity and food has risen, inflation in Australia is more likely above 5%.²⁹

The Carbon Tax

This is a tax meant to punish businesses for emitting carbon in order to reduce carbon emissions and fight global warming. Yet, this tax becomes an indirect tax on the taxpayer. The bigger businesses can just increase the prices on their products to maintain their profits. So, we end up paying more for our goods and services. The carbon tax is one of the many "hidden" taxes that we pay. Australia had this tax from July 2012 to July 2014.

The EU Debt Crisis

"At the heart of the European debt crisis is the euro, the currency that ties together 18 countries in an intimate manner. So when one country teeters on the brink of financial collapse, the entire continent is at risk. How did such a flawed system come to be?."

Bloomberg - "The European Debt crisis Visualised"

Drowning in Debt

Ever since the Financial Crisis in 2008, Europe has been drowning in debt. The amount of debt these countries have, it's a wonder that the debt bubble hasn't popped yet. The table below gives us a snapshot on the massive debt burden Europe is under.

Debt to GDP percentage of European Nations (Source: WWW.TRADINGECONOMICS.COM)

Nation	Public debt as a percentage of GDP
Greece	177%
Italy	133%
Portugal	130%
Ireland	109%
Cyprus	107%
Belgium	106%
Spain	97%
France	95%
UK	89%
Austria	84%
Hungary	76%
Germany	74%
Netherlands	68%
Poland	50%
Denmark	45%
Sweden	44%
Switzerland	34%
Turkey	33%
Norway	26%
Russia	17%
Kosovo	12%

Dominoes

The countries in Europe will fall to debt like dominoes; weakest first. The countries that go under will be bailed out by their neighbouring country taxpayers until the strongest countries like the UK, Germany and France crumble too. The first wave of bail outs in 2011-12 went to Greece, Cyprus, Portugal and Ireland. Now Greece is in trouble and Ireland, Spain and Italy are sure to follow.

A Flawed System

In his book, Quintieri states that "*With the Euro's "one interest rate fits all" policy, the system is doomed to fail.*" Europe uses one currency, one interest rate and one monetary system and this just makes things worse. Using the Euro is a real drag for them and disastrous for others.³⁰ This system allows the stronger countries to abuse the weaker ones and a frugal country is punished by wasteful ones. If the Euro plummets in value due to its misuse by a country the other countries are taken down with it and this applies the same with debt. The countries with little debt are still vulnerable, because others have too much debt. However, for weak countries like Greece this is a benefit in terms of maintaining purchasing power. This system puts a burden on stronger countries to keep the weaker ones afloat.

Germany is Europe's Crutch

Germany is by far the strongest country in the EU, but it has the burden of maintaining the weaker nations in the EU and growth in Germany has stagnated due to this. Germany is essentially Europe's crutch and it should seem that Germany should withdraw from the EU and unburden themselves. However, Germany can't as they own billions worth of bonds from the other countries in the EU.

Cyprus

Cyprus has become famous from their recent economic crisis in 2012-13 that involved a €10 billion bail-out and the first time ever use of bail-ins. The chain reaction from the US sub-prime mortgage crisis had lead to a recession in Cyprus in 2009, which escalated into a debt crisis. Cyprus soon had a debt larger than its GDP. The €2.5 billion loan in 2012 wasn't enough to keep Cyprus afloat and on march 2013, Cyprus got its €10 billion bail-out. At the same time there were massive bank runs occurring, which resulted in capital controls (people couldn't get their currency out of the banks) and a bank holiday taking place. The bank accounts in Cyprus then got a haircut of 50% or more to recapitalise the banks. This was the first bail-in ever, which Greece is now thinking about applying, and Cyprus as of October 2015 is still drowning in a debt of €25 billion, which is 160% of their GDP.

All Eyes on Greece

As of recent all eyes were on Greece as they crumbled under the enormous debt they had and as the EU and the IMF organised a bail-out for Greece that included austerity measures in the terms and conditions. It was also big news when Greece imposed capital controls on its population in June 2015. These bail-outs from the IMF didn't work and are just a form of kicking the can down the road by repacking the debt.

The Situation

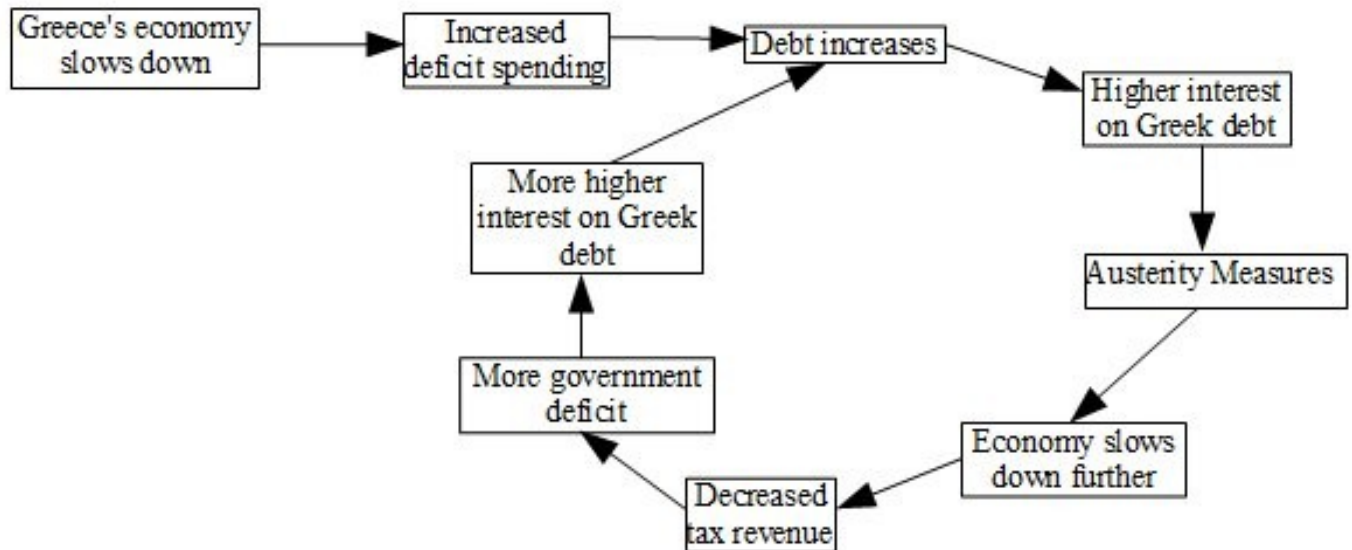
Greece since 2008 had its economic growth slumping and debt rising. Khan Academy in his video about the Greek debt crisis talked about how the Greek government was spending more than its income, which lead to a yearly deficit that results in increasing Greece's debt. This rising of debt also causes people to view Greece bonds as more riskier and they demand higher interest rates. This means Greece has to pay more interest on its debt. Greece tried raising tax rates to generate more income, but as shown in the past by the Romans and others, this results in less taxes being generated. Greece also faced the same situation as the US; they couldn't lower government spending. The Greek government had made promises to its people and decreasing government spending will cause riots and a collapse of the debt-based monetary system.³¹

Their Solution

Greece instead started robbing pension funds and selling of assets like monuments in order to pay their debt. Other nations like Australia also take currency from the pension funds in order to pay their debts. These methods for Greece though were not enough and the Greek government essentially found themselves insolvent.

Austerity Measures

Khan Academy explains Greece's spiral down in a video from 2012. Greece as part of its bail-outs had to impose austerity measures on its people. These measures involve more taxation and decreased government spending, but it also *"sucks money out of the economy and austerity leads to the economy slowing further"*³¹, which then decreases the amount of taxes collectable. This then increases government deficits and debt causing people to demand even higher interest on Greek debt. A viscous cycle (see below).³¹



Round One

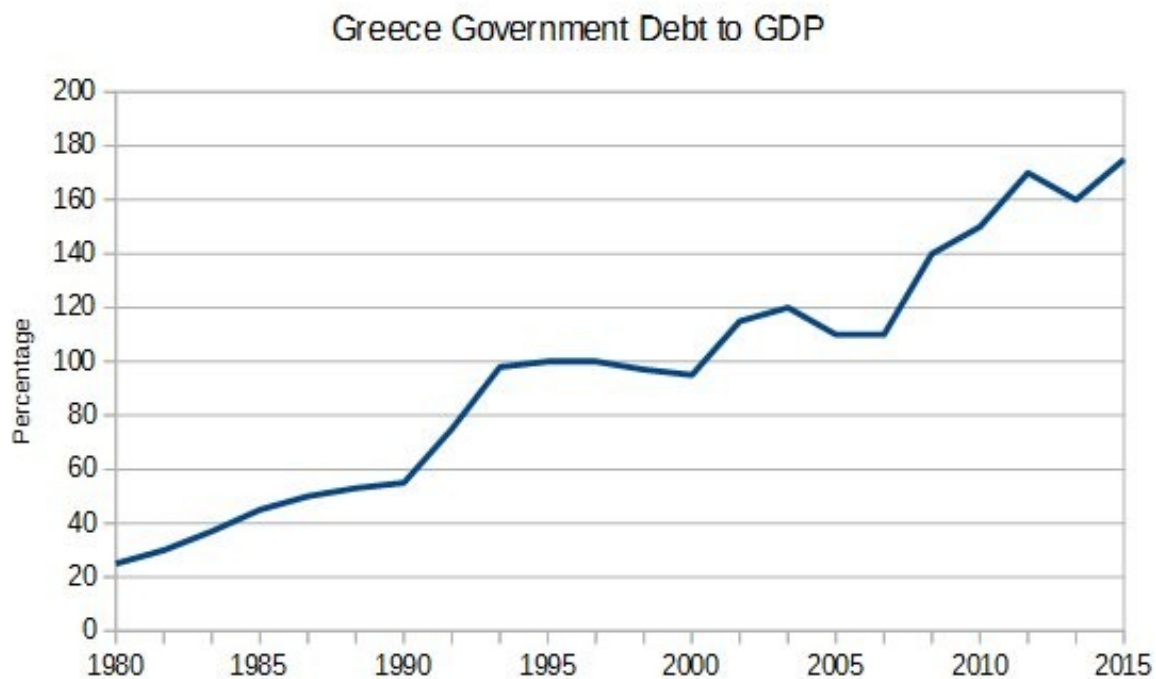
The Greek debt cycle above lead to the first Greek bail-out package of €110 billion May 2012, which would last for 3 years. This was the first of a series of bail-out packages that Greece got in an attempt to fix the problem, but instead it imposed more austerity measures and made the Greek economy worse.

Round Two

The first round of bail-outs didn't help Greece and its debt to GDP ratio continued to increase. The debt to GDP was 100% in 2008 and the Financial Crisis caused the Greek debt to rise rapidly reaching 160% by 2012 as seen in the graph below (on next page). The second Greek bail-out package of €246 billion was issued in February 2012 with the bail-outs lasting until 2016. This bail-out did decreased Greece's debt to GDP by 20%, but this figure has risen back up to 160% within a year; kicking the can down the road.

Round Three

The third round of bail-outs was very recent and was very big news. The Greece debt's credit rating had been downgraded significantly by now and the Greek economy was in shambles with its debt back up to 160% of its GDP. In January 2015 talks about a third bail-out began which went on for months and in June things started heating up. Greece was being pushed around by their creditors and the Greek government was forced to cave in despite trying to fight back. Leading up to June, there was talk of capital controls, austerity measures, bail-outs, Greece leaving the Euro and much more. Each part will be looked at separately.



Source: WWW.TRADINGECONOMICS.COM | EUROSTAT

The Referendum

On the 5 of July, the Greek Referendum for the bail-out was held. The Referendum was about whether or not to accept a bail-out package that required even more austerity measures being imposed. Being deeply unpopular, 61% of Greeks voted no, but within two weeks the Greek government accepted the third bail-out terms behind the back of its people. Greece essentially was bullied into accepting it with threats such as being thrown out of the EU.

Third Bail-out Terms

The terms of the third bail-out package was that Greece would be given an extra €86 billion throughout a year's time. Greece in return had to impose austerity measures that involved increasing taxes, reforming the pension system and lowering government spending.

Greece Defaults

Greece throughout 2015 was discussing with its creditors about its debt payments. Greece was forced to pay large debt instalments that "bleed" Greece dry. Greece was having all its assets being sold off to its creditors like the ancient Greek temples. The Greek government was getting increasingly desperate trying to find the capital to pay off its debts and on June 30, 2015 they missed their IMF payment of €1.6 billion. Greece essentially defaulted on its debts and this made them face even harsher conditions for the bail-out.

Capital Controls

On June 28, 2015, Greece imposed capital controls on the banking system as the banks were running out of currency. The massive bank runs taking place were making Greek banks become insolvent and this forced Greece to impose a daily withdrawal limit on bank accounts of €60. This included businesses, who then couldn't afford new stock, and people were not able to deal with unexpected large expenditures. This essentially would collapse Greece's economy.

Bail-ins

Where Cyprus went Greece would follow. The Greek bankers and government in July were discussing imposing a 30% haircut of accounts in Greek banks. *"This is I have been worrying about. This is what I been warning about now for two years."*³² This is what David Quintieri said in his video about the bail-ins, he saw the capital controls coming and yet the general public ignored it. Despite this bail-in plan not taking place, it sure will next time Greece is in economic disparity and also in other countries when their economies go into a depression. You need to get your currency out of the banks!

Line Up, Single File Everyone

People in Greece line up at bank ATMs in hope to get their currency out before it's gone. However most of them do not get their currency out because the ATMs run out of cash, as the banks are out of currency. In Greece what then happened is rioting, looting and people going back to bartering. The shelves in the shops are being cleared out as the situation worsens.

Current Outlook

"The Financial system went bust but it was bailed out by the government. The next time the train stops is when the governments go bankrupt. And that day I really look forward [to] because that is what they deserve."

Marc Faber

Things in Greece have calmed down since the bail-outs but things are sure to heat up again as Greece's debt increases again and next time the situation will be far worse. The world at extension had been bailed-out in 2008, but next time the crisis will be so big that the governments won't be able to bail-out themselves out of it.

Other Current Events

The Arab Spring

In 2010 to 2011, the Middle East saw a number of uprisings against their governments in nations like Egypt and the overthrowing of the ruler Zine el-Abidine Ben Ali. These revolts were coined the "Arab Spring" and saw the ruining of many innocent lives, but this event was also dangerous for the world as a whole as these countries are the world's main source of oil. A political upheaval can cut Western nations off from this source and lead to a global recession and an escalation in the price of oil like it did in the 1970's. However, the situation in these countries have since then calmed down, but the danger is still there and oil itself has taken a nose dive from \$100 a barrel to half that price since the start of this year.

Syria

The recent news in the Middle East are focused on Syria as Russia and NATO are getting militarily involved there. Russia is sided with Syria's president Assad and they have been setting up a base there and in the last few days of September 2015, Russia had been launching air strikes. The question David Quintieri puts is, is Russia protecting Assad or attacking the rebels and the answer to this is probably both.³³ NATO and the US also don't like Russia's actions in Syria and are trying to stop Russia from helping Syria.

Ukraine

In the first few months of 2015, Ukraine was front page news as Russia faced off with NATO and Ukraine. Russia sent their military into Ukraine saying that they needed to help them with their social crisis and over several months small scale fighting of rebels and Ukraine took place. Russia annexed Crimea and the fighting escalated somewhat and in September the US had moved 20 nuclear weapons to Germany, so this can become a real serious problem in the future.

Robotics

The danger robotics and automation poses to jobs can't be ignored. Robotics might be good at improving productivity and allows us to get robots to do the dangerous, demeaning and boring jobs, but it also takes jobs away. Robots recently have been tested or used to drive cars, fold clothes and to be financial planners.

Cashless Society

The world has been moving further away from cash in the last few decades. Cash has been replaced by credit cards and digital currency and now people are bringing up the idea of having a cashless society. This is a society where notes and coins won't exist or be in very limited quantities. All financial transactions can be traced and charged. Slowly we are moving towards a society like this as people want more convenience. A cashless society will be entirely confidence based and extremely vulnerable to inflation.

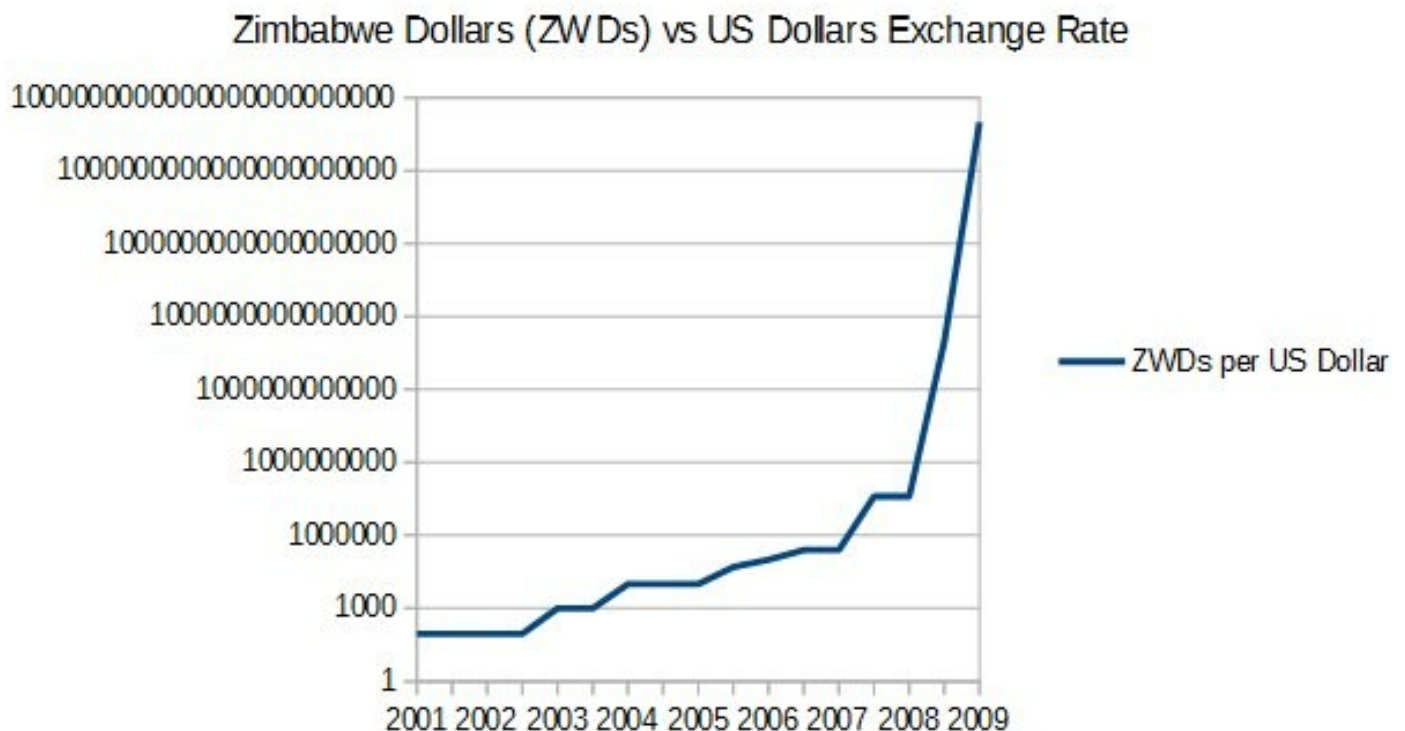
China asked to do a QE on commodities

China in mid November, 2015 was asked by several mining companies to buy up their excess stocks of metals like aluminium and nickel. This hasn't occurred since the Financial Crisis of 2008. These miners want this as it will increase the price of these metals and stave off financial disaster as these companies are now facing falling profits. If China agrees to this, then the metals market for these metals will effectively become manipulated.

Hyperinflation in Zimbabwe

The hyperinflation in Zimbabwe that took place during the Financial Crisis was one of the worst cases of hyperinflation in history. In the 1980s, Zimbabwe had a stable economy with the Zimbabwe dollar but over 1 US dollar. However things would take a rapid change as the economic freedom of the country were destroyed. Robert Mugabe in the 1990's did economic reforms with the World Bank and the IMF that sowed the seeds of economic destruction as the IMF, EU and the World Bank screwed up Zimbabwe's economy. Zimbabwe also had land reforms that devastated food production and shot unemployment to 80%. These events coupled with civil unrest and deficit spending doomed the Zimbabwe Dollar.

The Zimbabwe Dollar quickly lost its purchasing power throughout the 2000s with an annual inflation rate over one hundred. All that was needed was a trigger to set off hyperinflation, which the Financial Crisis was. In 2008 annual inflation shot from 1,300% in 2006 to 66,000% by the next year, which then exploded to 231,000,000% in 2008. This graph below shows the extreme hyperinflation Zimbabwe experienced within such a short time. At its worst, one US Dollar was worth 2.6 billion Zimbabwe Dollars. Zimbabwe instead of revaluing their currency started using foreign currencies like the US Dollar because things got so bad.



Source: Mound Sparks Academy

An Important Lesson

Zimbabwe's and Argentina's economies had collapse due to poor fiscal polices and Venezuela's economy is in the process of collapsing today due to poor fiscal polices and the funny thing is that these nations were once rich. Venezuela has rich natural resources. So what went wrong. Loss of economic freedom was the problem. Just because a nation is rich in resources doesn't mean it will be prosperous, as that nation needs economic freedom to achieve prosperity. These examples show the role economic freedom has on the level of prosperity a nation enjoys and less economically free countries tend to be worse off.

Venezuela

The annual report from Free the World gives a good statistical display on how economically free countries are and Venezuela is at the bottom. Venezuela once an oil rich prosperous nation had its economic freedom taken away and now the country is amidst in an economic collapse and a hyperinflation. Every sort of good or service is being rationed, people are rioting and bartering is being used. The government in Venezuela is very oppressive, as seen by how they will track how much you buy of a certain good to make sure you don't take more than your share. Martial law had been declared there too. This just goes to show how economic freedom effects an economy. Venezuela is at spot 152, Hong Kong is first followed by Singapore and New Zealand. The US is 12th and Australia is 8th.³⁴

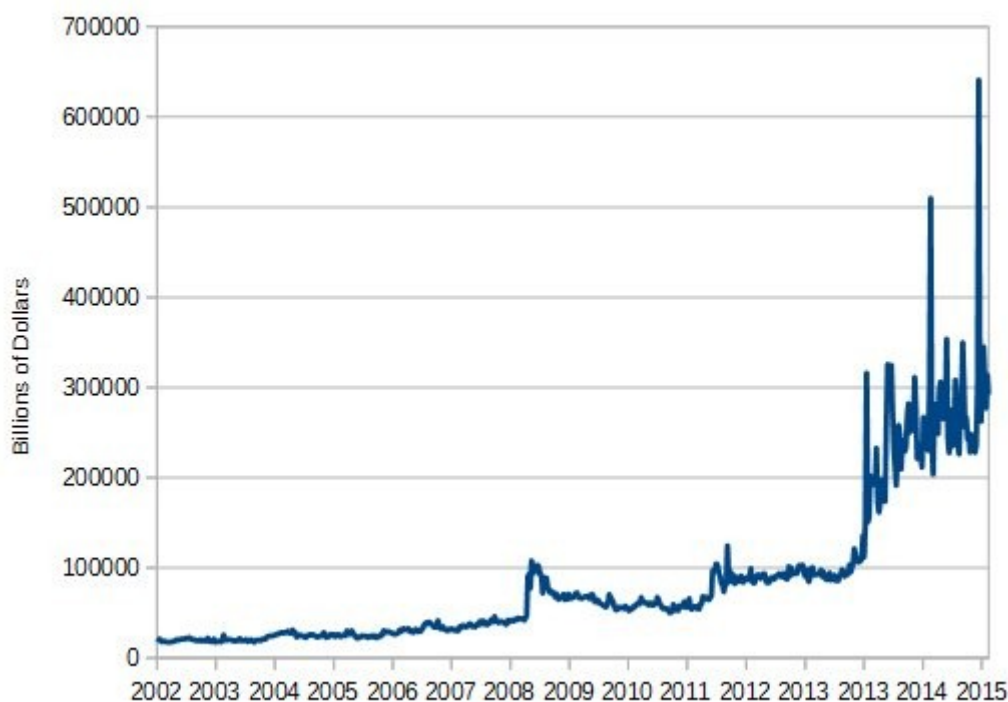
All-Time Lows!

The Baltic Dry Index measures changes in transportation expenditures for shipping certain materials around the world and so is a good indicator for global trade and economic conditions. The shocking news is that as of November 2015, the Baltic Dry Index has hit all-time lows! This is lower then during the Financial Crisis in 2008. Also the rate of transporting containers to Northern Europe to Asia has dropped by 70% in the same month and normally this rate should be rising at this time of the year. The last time a divergence from seasonal patterns in this rate occurred during 2008. This is just another indicator showing that the world economy is hurting.³⁵

Red Flags!

What this following chart shows is also cause for concern. It is showing the repurchase agreements (repos) held by the Fed. Just to clarify, a repurchase agreement is where the seller sells a security like government bonds to the buyer and then re-buys that security from the buyer at an agreed price in the future. These are normally short term. What is alarming about this graph is that it's showing current financial instability. The only time this graph was volatile was during the 2008 Financial Crisis where the amount of repos doubled and now the volatility is insane with the largest spike reaching \$650 billion. This graph is showing that the crisis can be close and that time to prepare for it is running out. Mike Maloney describes this chart as *"One of the scariest charts that I have ever seen."*¹³⁶

Reverse repurchase agreements held by the Federal Reserve: All Maturities



Source: Board of Governors of the Federal Reserve System (US), Reverse repurchase agreements held by the Federal Reserve: All Maturities [RREPT], retrieved from FRED, Federal Reserve Bank of St. Louis <https://research.stlouisfed.org/fred2/series/RREPT/>, November 29, 2015.

The TPP

The Trans-Pacific Partnership (TPP) has been getting a lot of coverage lately. The amount of secrecy behind this free trade agreement is increasing the suspicion that there might be something wrong with the TPP. The full text of the TPP has been recently released and should be reviewed to make sure that this agreement doesn't have any problems in it.

A New Monetary System

The possible future monetary systems we have vary. China's Yuan might be the new reserve currency, the IMF is thinking of using the Special Drawing Rights (SDR), gold and silver might become the medium of exchange again or Bitcoin becomes the new form of currency.

Future Outlook

The current future economic situation is filled with uncertainty and all we can do is prepare for the worst. When exactly the crisis will happen is hard to predict; it can be in months or years, depending on the choices the governments make within the next few months. Rising interest rates for example will bring the crisis date forward by a large degree. However what is certain is that the crisis will occur within this decade or very early on within the next.

Investing

Throughout this book it was hinted that this upcoming crisis isn't all that bad, as it's also a great opportunity to make money from it. Never before had fiat currencies been used on a global scale and this economic crash as said by Mike Maloney is "*The greatest wealth transfer in history, therefore it's the greatest opportunity in history*"³⁷ The wealth will be transferred from those holding paper assets like fiat currencies to people holding real assets like gold and silver. This chapter will discuss investing and the different investment options out there. Diversification is important, you can have some paper assets, but having some real assets to protect your wealth is essential to be ready for this event. Once positioned right, you don't have to worry any more as you are ready to face the upcoming storm. Let's see how it's done.

Fundamentals of Investing

Purpose of Investment

"An asset puts money in your pocket and a liability takes money from your pocket. The rich understand the difference and buy assets, not liabilities."

Robert Kiyosaki

The purpose of an investment is to to make gains from it. The important part of investment is in what to invest in and how much of your wealth you put into investments.

Intrinsic and Face Value

There are two different values given to assets: intrinsic (real) and face (nominal) value. The intrinsic value is its natural value and the face value is the value given to it. Adam Smith in his "Wealth of Nations" explains labour is the best measure of value and the real value of an asset or commodity is measured through labour. The nominal value is given to it by the state and these values fluctuate. The face value of an asset can go to zero, while its real value is maintained.³⁸

Paper and Real Assets

In terms of investment there are two forms of assets, which are the different forms of investments available. Paper assets are the most common and though being able to be more convenient are fiat and vulnerable to inflation. Unlike real assets, paper assets can go down to zero. Paper assets include:

- Stocks
- Bonds
- Mutual funds
- Investment accounts
- Superannuation
- Debentures
- Exchange Traded Funds (ETFs)
- Derivatives

Real assets are less common than paper assets and have to be in a physical form, while paper assets can be digital. Real assets are a hedge against inflation, particularly gold and silver and besides precious metals, real assets include:

- Real estate
- Copper
- Oil
- Any other physical commodity

Risk and Return

Risk and return is used to measure the suitability of an investment. The return of an investment needs to be great enough to overcome the risk involved and the higher the return, the higher the risk generally is. In an ascending order the amount of risk and return assets commonly have are precious metals, real estate, investment accounts, debentures, bonds and stocks. However the risk and return of these assets are not normal in the current situation such as gold and silver offering a potentially huge return and real estate having a very high risk. This term will be used throughout this chapter as the risk and return of each asset class is examined.

Gearing

Gearing is using debt to invest and allows an investor to buy more assets than they normally could. The principle of gearing is that the returns of the asset invested in will cover the repayments on the debt and so gearing needs the asset to rise in value for it to create capital gains. Yearly profits tend to be negative, but the capital gains will make up for this and gearing can give a high return.

Diversification

Diversification is essential when investing as it lowers your risk by spreading it between many different investments. By having many investments, the chance of a loss is less and the probability of several investment failing is much less than one investment failing. So, when investing, invest into several different assets, but make sure you aim for real investments to protect yourself against inflation.

Fixed or Not

Interest on investments are either fixed (remains the same) or variable (fluctuates). Fixed rates are safe from rate hikes (increased interest rates), while variable rates aren't as they will change with the financial markets. Fixed rates on loans would be better than variable rates as you can take advantage of the very low interest rates while not worrying about interest rate hikes.

Over or Under Valued

The value of asset classes will fluctuate over time depending on demand and supply, regulations and other factors. The assets tend to move from overvalued to undervalued as their market price seeks fair value (natural price). In the Wealth of Nations, Adam Smith explains that a commodity has its natural price and the change in the market price is the attempt for to get closer to its natural price when supply meets effectual demand.³⁸

Measuring the value of assets involves deciding which figure indicates that it's overvalued, fair priced or undervalued. One can simply look at its price and calculate these figures by looking at when the asset was in a boom and in a bust, but comparing prices is limited and can not be very accurate. Instead measuring an asset against another or against other key figures really helps to determine the value of that asset. Using the P/E ratio for instance is useful when measuring if a stock is over or under valued. This area of measuring assets ties into wealth cycles, which will be discussed after looking at each of the different kinds of assets.

Measuring in Units/Ounces of Assets

Mike Maloney in one of his videos when responding to questions explains why is better to measure your investments in terms of ounces or units instead of the currency value. Such as measuring your gold holdings in ounces and seeing what each ounce can buy instead of measuring those holdings in US Dollars and then seeing what they can buy. He states that it *"doesn't shake you out and ounces determines how much you'll be able to buy."* He also states in this video that when looking at statistics be careful about CPI adjusted statistics. You have got to make sure the statistics are unadjusted or you are getting false information.³⁹

Government Bonds

"Eventually the interest payments on the debt will be so huge that they will just have to print money. Then they repay in essentially worthless confetti."

Marc Faber

What government bonds are has already been discussed in the sections "[How Our Debt System Works](#)" in the "Fundamental of Economics" chapter and "[Origins of Stocks](#)" in the "History" chapter. Governments tend to spend more than they make and they issue bonds to fund this deficit spending. Big investors buy these bonds, to which the governments pay the principle plus interest over time, furthermore, these bonds are also traded between investors.

Common Characteristics

The bonds are a long-term investment that tend to be low risk as the government normally pays its debt and bonds offer a steady income. Bonds are commonly large scale investments as they are issued in large dominations like millions. Bonds themselves are vulnerable to inflation and those living off them should definitely invest in other assets in case inflation sky-rockets.

Current Situation

If one wants to know on how to throw their currency away; buy government bonds. Buying governments bonds now would just be ludicrous with the sky high risk and rock bottom returns that come with them. The amount of debt governments today are in is just astonishing and this monstrous debt makes the likelihood of government default extremely high. Return is almost none to even negative as the extremely low or negative interest rates means that the interest earned on the bonds are negative. So you pay the government to use your currency. After the debt bubble pops and the economy then can recover after it got all the "trash" out of it, buying bonds could be an option then as they would be undervalued.

Stocks

"The reality is that business and investment spending are the true leading indicators of the economy and the stock market. If you want to know where the stock market is headed, forget about consumer spending and retail sales figures. Look to business spending, price inflation, interest rates, and productivity gains."

Mark Skousen

Let's dive right into it. The fundamentals and history of stocks have already been covered and so let's focus on the investment side of stocks. Often you would have heard the saying "buy low, sell high", this is a good principle, but there is more to it such as making sure a stock is undervalued.

Buying into the Right Company

When buying a share first have a close look at the company. Do they release quarterly financial statements? This is important as it helps you track their cash flow. Quintieri in the "Money GPS" advises to avoid companies that don't release quarterly financial statements.³⁸

Measuring Stocks

The P/E ratio is a good way to measure stocks, but measuring stocks against gold is another good indicator. Using the latter indicator, stocks are seen to be overvalued with their value reaching pre Great Depression highs.

Earnings from Stocks

The share market isn't just about asset growth, but also about dividends. David Quintieri has talked about how assets can create a cash flow to live off and the dividends of stocks can do this.² Having a stock can earn a return through a dividend or by growth and just because a share loses value, don't sell it off if that share offers a good dividend yield. So shares earn a return by asset growth and by dividends. Changes in exchange rates will also effect returns when trading in foreign stock markets and therefore a stock can earn returns in three ways.

Above Inflation

Most paper assets give returns below inflation however stocks are one of the few investments that do earn more than inflation.

The Stop Loss Option

As stocks can quickly lose value, a stop loss option can potentially stop you from losing too much as a stop loss will sell off all your stock holdings if their value drops to a certain value. It might cost more, but the protection is worth it.

Make Up Your Own Mind

Warren Buffet is a very famous investor, who suggests that one should invest in companies whose shares are under-priced. This advice, despite coming from the elite is still accurate, but it shouldn't be fully believed. Anyone's financial advice shouldn't be blindly believed, but you should instead use that advice to make up your own mind. As such this book also gives you advice but it is up to you what you do with this information.

Zooming Out

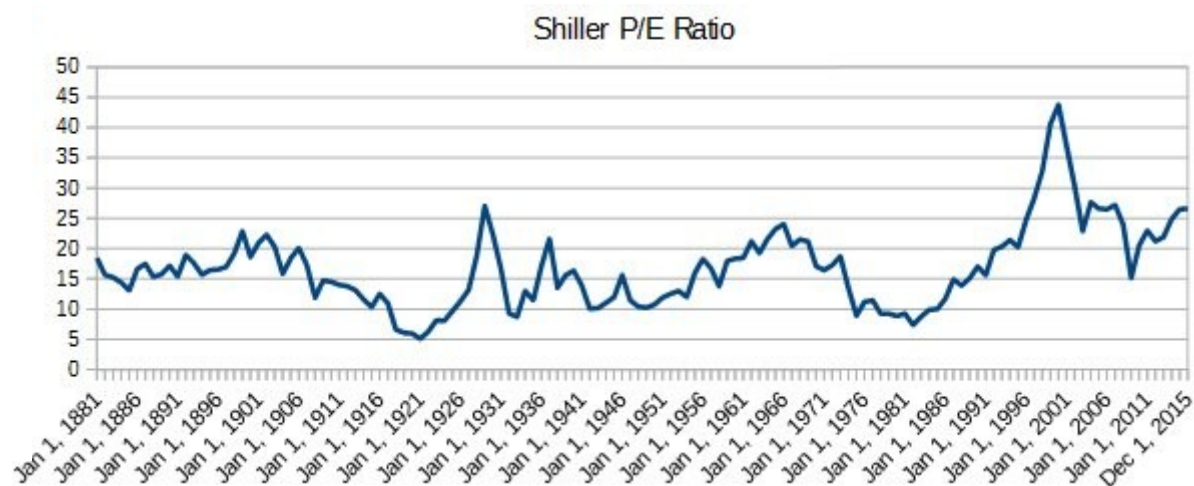
David Quintieri looks at a principle called zooming out. He explains that you shouldn't just look at one company, but at the stock market as a whole. If you look at a technology company, the NASDAQ and then the stock market as a whole you will find out how these move together. By doing this you can connect the dots and see the big picture.⁴⁰

Real Investment Out, Fake Investment In

As things get worse, more investors take their currency out of the stock market, which then falls as a result and this will make governments do some QE to drive the stock markets back up. When this happens, the real investment are leaving and the fake investment coming in to the stock markets.

Overvalued Stocks!

It's no joke that the stock market is overvalued at the current time. The P/E ratio of the S&P 500 (average share price of the 500 largest American companies) as seen by the graph below is 25. This graph was made by Robert Shiller, who compiled data for the 500 largest American companies back to the 19th century to create this graph. To refresh, a P/E ratio below 10 is undervalued, above 15 is overvalued and above 20 is a bubble. So currently investing in the stock market is certainly not a good idea, especially with the stock market currently dropping and being very volatile right now.



Source: MULTPL.COM

Possible Options

If you want to diversify and still want to invest in stocks. You should be careful. There are still certain companies that could make a good return, for example, Volkswagen. This massive German company after the scandal with them being misleading about being green had their share price plummet, but their P/E ratio is now 8. This can give a potential for their share price can go back up, but this scandal could lead to further drops in their share price.

Mining Stocks

Another option in stocks are mining stocks. The share price of mining companies tend to follow the market price of precious metals and other raw materials and so a rise in the price of gold and silver can cause the share price of mining companies to soar. A mining company does well in a situation like this because they will be holding commodities of great value and their share price will reflect this.

ETFs

Exchange Traded Funds (ETFs) are one of the many new types of investment. ETFs are sold and bought like shares and could be considered a derivative as they derive from an underlying asset. They behave like mutual funds with someone managing them for the owner, who can then sell and buy the ETFs like shares in a company. These funds are divided into shares, which investors can buy and sell. The price of the ETF will change along with the price of its underlying asset.

Shorting the Market

There are many forms of ETFs you can find with each one behaving differently. Certain ETFs will behave in an inverse or scaled fashion in comparison to the asset it is linked to. To illustrate this consider an ETF that is linked to the Dow Jones and then the Dow Jones dropped by 5 points. Then the ETF will rise 10 points as it does the inverse to what the Dow did multiplied by 2. This allows one to make gains even in a bear market by betting that the market will go down.

Multiplying Gains

As just illustrated an ETF can be set to do a multiplied version of a change in its asset such as 3x silver ETF will rise 3% per each 1% silver rises. These types of ETFs can make rapid gains, but also quick losses too.

Easy and Cheap

ETFs are a popular financial instrument as they are fairly cheap and are another way to get into the stock market without buying stocks. But as other derivatives an ETF may not be fully backed by assets.

Debentures

Like stocks and ETFs, debentures are another way to invest into companies, but debentures are more long-term and less risky. A debenture is when an investor lends a business an amount of capital for a lengthy period of time, which offers a relatively low rate of return. However what makes a debenture a safe investment is that when the business fails and is liquidated, those holding debentures are among the first to be repaid their losses. So the chance of losing your investment in an event of business failure is much lower than most other investments.

No Real Backing

There are variations on the type of debentures available for investment. Some of which do not provide security and others which offer the investor first ranking security over the assets typically via a trustee (Someone who acts on your behalf in regards to the investment). However a debenture is still a paper asset.

Unsecured Notes

These are similar to debentures, except that they offer higher returns and are one of the last to be repaid in event of a business failure.

Let's Get into Groups

Debentures like ETFs and mutual funds can be run by an individual, who manages several debentures at once. A group of investors are placing their bets that this person will make gains for them.

Real Estate

Property is one form of investment that everyone has heard of. A property or house is a large asset that most people have and can be used on a rainy day, but a house as a viable investment is something the majority don't have. A house isn't considered a real investment if it's used for living in. A real investment in a house for someone is when they own it separately from the home they live in.

Houses and Property

Real estate involves houses and the property that it's on. Real estate is a very large and popular type of investment that has been used for many centuries for investing. Back in Victorian England, property was a symbol of status that made gains thorough agriculture. Today you have big time investors that will buy and sell millions of dollars worth of property in an attempt to make gains.

As Safe As Houses

"So no, property isn't a uniquely safe investment. House prices can go down as well as up and as assets go. houses are pretty illiquid, which means you can't unload them in a hurry if you get into a financial jam."

Niall Ferguson - "The Ascent of Money"

Property is often looked upon as a safe investment that can guarantee returns and be past down through generations. However as history shows, the saying "As safe as houses" is not altogether that true, as the 2nd Duke of Buckingham will tell you. He had fuelled his excessive spending through loans secured by his vast amounts of properties. He would repay the debt from agriculture sales, but the fall in grain prices in the mid 1800s caused the first property crash and the Duke found himself selling off all his assets and having his status severely reduced. The more recent property crash in 2008 gave a stark warning to property owners that real estate can lose value too.

Think Smart

Property can make gains in more ways then just growth. By renting your property out to tenants you can create a cash flow from that property, which if big enough can cover your expenditures and allow you to live off the income. Instead of selling a property, which involves certain costs like legal fees, keep it and rent it out to tenants. David Quintieri suggests that "The only time it does makes sense to sell is if you're going to upsize to a larger property allowing you to split it further, thus giving you more rental income."² Property is an investment that you can live off if used right.

Renting

Renting out your property to tenants will make the extra houses you own not a liability, but a source of income. The rent can be used to pay off the expenditures of that property such as a mortgage and rates. Renting does carry its risks of tenants damaging your property, defaulting on their rents or moving out. The first issue is dealt with by owning a house with a strong structure like brick walls and choosing the tenants carefully. The other two issues are fixed by moving several tenants into one house, if one moves out, the other tenant is still there to pay the rent.

A Real Asset

Since property is a real asset it's a hedge against inflation. If it loses its market price, the house still contains a natural price that will remain even during a hyperinflation.

Gearing

"Cash flow' is the most important word in the world of money... The second most important word is 'leverage'. Leverage is the reason some people become rich, and others do not."

Robert Kiyosaki

The use of gearing in real estate has the potential to make big gains. Gearing can allow you to use leverage to buy more properties than normally and the rent on these properties can be used to repay the debt. Gearing will work best in a bull market with you making gains from that rise and the rents might even be enough not only to pay the debts, but to make profits on the side.

The following scenario will show you how useful gearing is. For this scenario, you have \$100,000 and houses cost \$100,000 and rent is \$100/week and the price of housing rises by 10% within a year. Without gearing you can only buy one house and you only make \$5,200 from rent and \$10,000 from growth within a year. While using a leverage of 20% you put \$20,000 in each house and the other \$80,000 is loaned from banks. You can buy five houses and make \$26,000 from rent and \$50,000 from growth within a year. Even when taxes, debt repayments and other expenditures are included the returns from using gearing are still well above the returns made without using gearing. Also, after you have paid the debt back, you then still own those five houses. The leverage in housing can also be much lower than 20%. This is the power of leverage.

Where to Buy Property

Just like any other asset, you have to take into account if the property is overvalued or undervalued. In Australia and Canada property is clearly overpriced, except in the Australian mining towns where property dropped in value from the result of the Mining Boom ending. The housing price/income and mortgage/rent ratios are two good indicators when determining the value of housing.

Mortgage/rent ratio: This ratio indicates how much you pay to buy a house for every dollar you get in rent, so the ratio has to be below 1.0 in order to make renting profitable. According to "Who Crashed The Economy" this ratio in Australia is 1.5, meaning that you would have a 50% loss when renting in Australia.⁴¹ In the US this ratio was 1.8 during the housing bubble, but despite having plummeted it still isn't at its historical average of just above 1.0.

Median house price/median household income ratio: As explained previously this is the median house price divided by median household income. In Australia its ratio is around 7 (overvalued) and the houses in the US are three times greater than income (slightly overvalued).

David Quintieri in his book "The Money GPS: Guiding You Through An Uncertain Economy" outlines several indicators to take into consideration when calculating the value of property and vacancy rates. For vacancy rates to drop and prices to rise:

- Jobs must be coming in.
- The house must be close to public transport.
- The house must be close to services like hospitals.
- The house is good for someone renting.⁴⁰

If a place has high vacancy rates like in the US, then it's obvious that buying a house in that area is a bad idea. The US themselves are reported to have a vacancy rate of 7%, but considering conditions over there and that governments "alter" statistics, we can presume that vacancy rates are much higher.

First Gold and Silver then Real Estate

Mike Maloney talks about how you could make a much larger return by moving between assets. By first investing into gold and silver and then real estate you can buy more houses than if you just bought houses straight away. This is a case of wealth cycles with assets fluctuating between overpriced and under-priced when compared with each other. If you take that scenario from the "gearing" part, you can only buy one house, but if you bought gold and silver and they had a 100% rise you can then buy two more houses. Mike Maloney predicts that precious metals will rise by several times and property will plummet in value.⁴²

Commodities

When you think about investments, you normally think real estate, stocks and bonds, but investing is more than that. You can essentially invest in anything, provided of course it creates a return. People could invest in oil, copper or even water! These are commodities, which also experience price fluctuations that an investor could take advantage of. Consider this: oil was pricey and in a shortage in the US in the 1970s. Nightmare for most, but opportunity for an investor, because if you hoarded petroleum before the oil crisis you could have made a handsome return. You just don't often have investors going into commodities due to the inconvenience. Now, investing into commodities can be an opportunity as many of them are in a shortage.

Deflation

The way this currency crisis will unfold is a deflation and then an inflation and prices of commodities will sharply drop and then the governments will over react and print us into a hyperinflation. As people rush to precious metals, the price of gold and silver will rise as many other assets lower in price. This deflation has been seen in an extreme with the price of crude oil going all the way down to \$40 from \$100. Yet pump prices for consumers are still very high, which means just more corporate profits for the petroleum companies.

Copper

Copper is also said to be in a shortage. An article from the Wall Street Daily states that copper's price has recently took the plunge as China's demand for copper is rapidly decreasing. People think there is a copper surplus, yet the world's largest supplier of copper, Glencore, says that they are almost running a deficit. Rio Tinto reported to the Financial Times that they "will have to add the equivalent of a new Escondida [mine] every 15 months" to meet future global demand and "*Escondida is the world's largest copper mine*".⁴³ Copper is an asset with many industrial applications, especially wiring. Now, people are trying to find ways to reduce the amount of copper used in wiring. For this reason and that copper is a base metal, copper might not be the best investment.

Running Short

Other commodities like zinc and lead, which are heavily used in industry are also running short of supply. With fewer and fewer trees on the planet, we can also expect a shortage of lumber to develop. However you can see demand for many commodities drying up as the world goes further into recession and this will cause prices for commodities like lumber to drop. This deflation is an opportunity for itself as you can buy up many commodities at very cheap prices, which will then sky-rocket in price when demand picks up again. But, beware that advances in technology can reduce the demand for these commodities.

Investment Accounts

The name "investment accounts" might make this form of investment foreign, but everyone should know what investment accounts are. This is another name for the savings accounts you have in the banks. This is when you loan currency out to a financial institution and you receive interest payments in return. Most accounts are accessible at any time, but the accounts that aren't accessible for longer periods of time offer higher rates of returns. Investment accounts typically are very safe, but not any more.

Why Not to Invest

With the way things are now, investment accounts offer negative or no return with the extremely low interest rates and investments accounts are very risky with the risk of capital controls and bail-ins today. When things go south, there are massive runs on the banks like in Greece. Yet even with the risk of bail-ins and negative interest for investment accounts in almost all Western countries people still keep loads of their currency in those banks. My advice is that you get your currency out of the banks and invest it in other investments, but of course you need to keep a certain sum of currency in the banks for living expenses. When investing as a whole, you need to keep some currency aside for living expenses.

Most aren't Prepared

Most people aren't ready to face a crash with them having almost no gold or silver for example and of course getting ready is important. However a majority of people are poor or in debt and so preparing is harder. People in that situation need to get out of debt as far as possible and at least get your hands on some gold and silver, even junk silver can work.

Bank or Credit Unions

In a video David Quintieri discusses whether or not credit unions are safer than banks. Banks are owned by the shareholders and you as a customer are loaning them your currency and you have no say on how the bank is run. Credit unions on the other hand are owned and run by the people who have their currency invested into it. A credit union in that regards is safer as your currency can't be bailed-in by the banks, but it doesn't protect you from inflation.⁴⁴

Superannuation

In the US this is known as an Individual Retirement Account (IRA). Super is a compulsory retirement fund used in Australia. Normally 9.5% of your income from employment goes to super, but you have the option to put more in. You have a choice out of industry, commercial or self-managed super funds with different investment strategies. Super is normally invested into stocks, which of course is a problem with the stock market being in a bubble and have a self-managed funds allows you to invest your super into precious metals too. However there is a lot of paper work associated with self-managed super and you might not be good at investing and also super funds invested into precious metals will mostly likely be invested into paper forms of gold and silver. So having a self-managed super might not be worth the effort.

Taxation and Super

Income that is put in super is taxed less and by putting more currency into super you could reduce your taxes. Investing into super also allows you to avoid capital gains tax, which is taxed on gains made through investing. However super is a paper investment that is vulnerable to inflation.

Precious Metals

"If you know how the world financial system works, you know the game that you are playing and if you don't know the game and the rules that we're playing by your going to get slaughtered...I could see that there wasn't anything in history as far as finances go that was as much as a sure thing as gold and silver accounting for the expansion for the fiat currency supply."

Mike Maloney - "The Case for \$20,000 oz Gold – Debt Collapse – Mike Maloney – Silver & Gold"

Precious metals are the rare metals like platinum, gold and silver that either have practical applications, an aesthetic value or both. Gold and silver are the main forms of precious metals used in investing. Gold and silver are the best hedge against inflation and are a safe haven during hyperinflation as gold and silver store value much better than any other investment.

Paper vs Physical

When looking at gold and silver you have the spot price and the price of the physical bullion. What you need to know is that the spot price is impacted greatly by the buying and selling of paper based gold and silver like derivatives. During a crisis the spot price can drop, but the physical price can rise. This is due to the buying of bullion and selling of paper assets and a shortage in physical gold and silver develops. In 2008 this happened when the spot price fell, but the price of bullion rose and it happened again in October-November 2015 as higher premiums were charged for bullion due to shortages, while the spot price went down. Most of the gold and silver said to be there doesn't exist as there is much more paper based gold and silver than physical gold and silver, which leads to a manipulated market price of gold and silver.

Buy Physical

As stated above the paper forms of gold and silver have no value and so will become worthless confetti during the crisis. Therefore when buying gold and silver you need to get the physical bullion like coins and bars. You don't have the physical form until you actually are holding it. Having your holdings stored away somewhere runs the risk of having it being confiscated or having actually nothing but an I.O.U and you need gold and silver on hand to barter with if things get really bad.

Where and What to Buy

When buying it's obvious that we need to be careful that the supplier is reliable and that you aren't getting scammed. In the US you can buy gold at GoldSilver and GoldMoney and in Australia you can buy gold at the Perth Mint or at the Australian Bullion Company (ABC Bullion). ABC Bullion tends to have lower prices than Perth Mint.

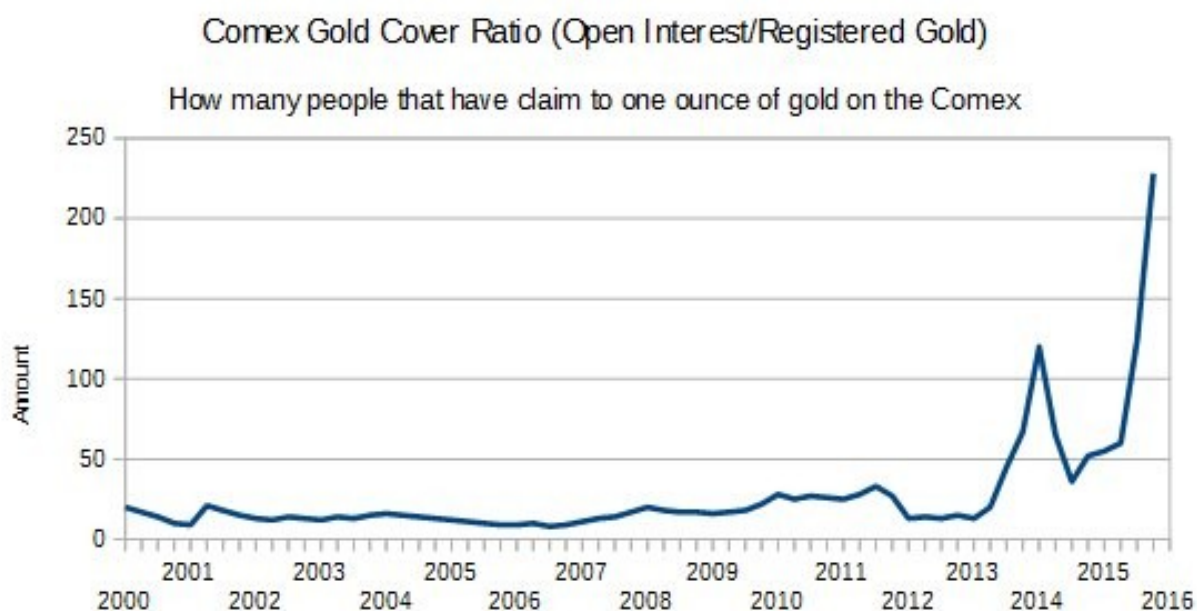
When buying avoid pool allocated gold or silver and aim for the small stuff. Buying small coins and bars makes trading easier and buying in bulk will give you lower prices. Bars will have lower premiums than coins, but you won't be able to take advantage of premium rises due to shortages in coins. Also avoid collector coins with high premiums.

You should consider buying more silver than gold despite your guts telling the opposite. This is because silver will have to rise more than gold. After gold gets too expensive, people will then rush to silver and then silver's price will rise. Not only does silver's price have to "correct" itself, but it will have to rise further to rebalance its ratio with gold and so you can buy more with silver than gold in the end (case for silver explained in detail latter). You should aim to buy two thirds silver and one third gold for precious metals.

Manipulation

It has been documented time and time again that the price of gold and silver are being manipulated. Not just in the sense that the paper assets bring the price of gold and silver down much lower than they should be, but that big banks actually have the power to change their prices. Some Swiss regulators have just caught several banks like HSBC and Julius Baer rigging the price of gold and are now investigating this. This situation is just one case of manipulation of prices. The banks rig the prices in order to make more profit and the US government has also been seen manipulating the price too. Despite all this evidence many still seem to believe it to be a conspiracy theory.⁴⁵

Yet this manipulation goes further. Remember how the amount of derivatives in gold and silver are much larger than the physical stuff. Well this has created as Mike Maloney puts it *"The commodities exchange has become part of the biggest gold and silver scam in the history of man kind."* The amount of gold registered in the Commodities Exchange (COMEX), which is gold available to buy is much less than the amount of holdings to gold people have claim too. Due to recent fears in September the amount of registered gold has dropped and the number of people holding claim to each ounce of gold has sky rocketed. This graph is showing how 228 individuals have a claim to each ounce of gold and this has gone above 252 shortly after the graph was created. This is clearly showing the scam in this system with 228 times more paper based gold than real gold. When people default on their contracts the price of gold will rapidly rise as people find out that there is a shortage of this rare metal.⁴⁶



Source: Zero Hedge

The Free Markets

"When you have a perfect free market, it's difficult to predict the future. But when you have a market that is disturbed by government manipulations and money-printing, it's impossible to make any predictions."

Marc Faber

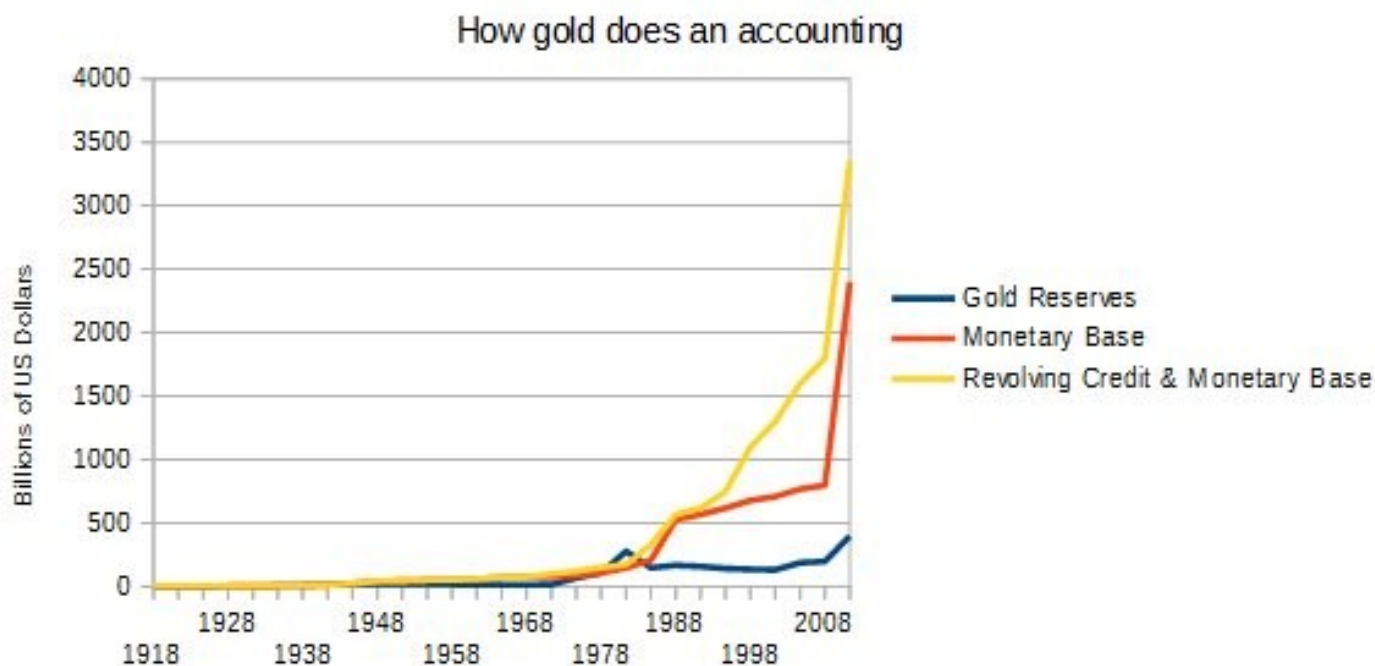
The free markets are what decides the market prices of commodities and assets but today the governments and bankers control and manipulate the market prices and end up fighting against the free markets. With these controls normal sense in predicting future finances is much harder and we all will pay dearly for the mistakes made by those who think they can control the free markets.

Stages of a Bull

Gold had been in a bull market for and outperformed all other assets during the first 8 years of the 2000's. David Quintieri states that there are three types of bulls. This was a slow bull market where not many know about it. In the 1970s there was a moderate bull market where more people know about it and the asset rises faster. The end of the 1970's bull was a strong bull market where the asset was front page news and everyone was in on it. A strong bull market rises rapidly and a bull market tends to go from slow to moderate to strong.

Gold does an Accounting

One of the key reasons why gold and silver will be a good invest is the historical examples of gold during an accounting of the monetary supply. This accounting is where the price of gold will rise until the value of all gold reaches the value of all currency in circulation. The graph below is using data from Mike Maloney's video titled "The Case for \$20,000 oz Gold" and from his book: *Guide to Investing in Gold and Silver*. This graph is showing the total amount of gold in the US vaults vs the monetary base (M1 currency supply) of US Dollars and the vertical axis is measured in billions of dollars. In each crisis event that involved a change of a monetary system gold did an accounting of the amount of US Dollars in existence by having the price of all gold meet or exceed the price of all US Dollars in circulation. In the Great Depression and in the 1970's the unpegging of the dollar from gold resulted in gold doing an accounting and soaring in price. Mike Maloney explains that the difference between the total price of gold and the total amount of US Dollars is the opportunity and this spread is further then ever. This spread is even greater when credit is added on top and this graph is from 2011 and since QE3 had increased this spread further. So the accounting required now will see gold's price multiply in value even more.⁴⁷



Source: Hidden Secrets of Money I, Mike Maloney

A Draw Back

After the bull market in the 2008s, gold had a drawback in price. This occurred before the 1970s gold bull market and so we could expect a similar thing.

The Case for Gold

Gold is also an undervalued asset when compared to other assets. Stocks and housing are a good measure when calculating gold's value. The first graph is the shares of the Dow Jones divided by the ounces of gold. For Gold, overvalued is 2 or below, fair value is 3 to 4 and undervalued is above 4 and by looking at the graph, the Dow was overvalued during the various booms in 1929, the 1960's and in 2000 and that gold was overvalued in 1978 and in 1930. The further overvalued an asset is the more overvalued it has to become and the swings between each extreme has become more wider and so gold would need to become twice the price of the Dow before being able to go into a boom again.



Source: Macro Trends

— Dow to Gold Ratio (Ounces)

How this Time Is Different

The previous bull market during the 1970's involved only Europe and America and news was travelling slow, but today the whole world can join and news moves much quicker. This gives just another reason for the rise in gold to be that much greater and quicker.

Wealth Cycles

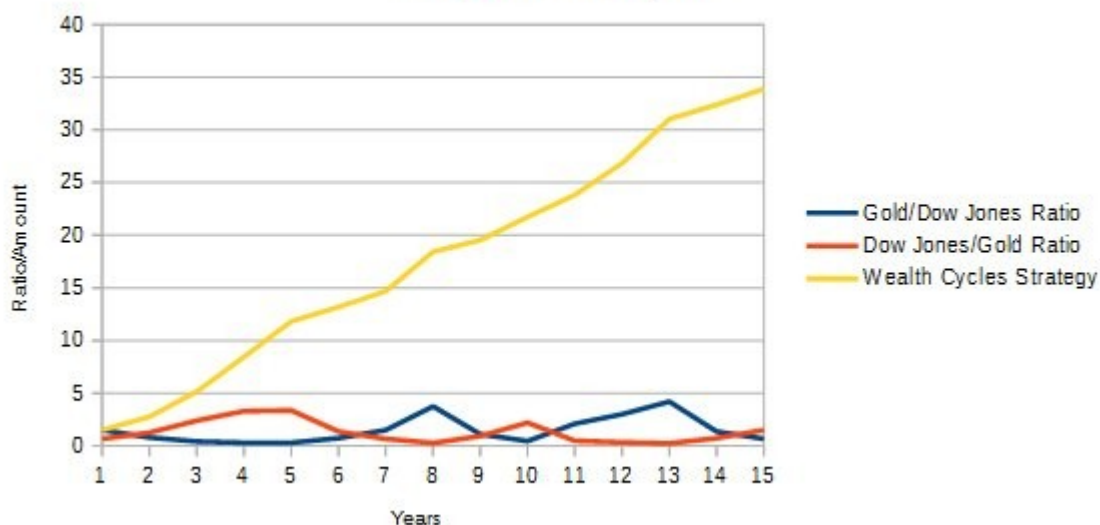
Table 1

Year	Price for an ounce of gold	Price of a share of the Dow Jones
1	150	100
2	120	150
3	100	240
4	90	300
5	80	270
6	110	150
7	150	100
8	450	120
9	300	280
10	180	400
11	210	100
12	240	80
13	210	50
14	150	110
15	100	150

Wealth cycles is the principle that assets go from over valued to undervalued and this can be used by an investor to make massive gains. You buy an undervalued asset and then sell it in exchange for another undervalued asset when the first asset becomes overvalued. When this second asset becomes overvalued you then rebuy the first asset that is now undervalued and you repeat the process.

Let's take an example of hypothetical prices of the Dow Jones (Dow) and gold. The table to the left displays their hypothetical price over 15 years. The graph below shows on the blue line gold divided by the Dow and on the red line the Dow divided by gold. The yellow line shows the gains that can be made by using this strategy. If you were you hold stocks from year 1 to 5 and then move to gold from year 5 to 8. Then move back to stocks from year 8 to 10, then back to gold from year 10 to 13 and then finally back to stocks from year 13 to 15. If you did this your gains would be massive.

Example of Wealth Cycles



Silver Shortage

Silver is currently a better investment than gold because it's in short supply. Normally there is one ounce of gold for every nine ounces of silver, so their prices should be in similar ratios, but now it's a 73rd of gold's price. That means silver's price has to increase by seven times in order to reach fair value. Yet the normal ratio today would be one gold ounce for every nine silver ounces as the supply of silver is decreasing. Also, the low price of silver is below production price and so silver miners can't make any profit with high grading. High grading involves going after more dense silver ores to reduce costs and the lower grade ores are left. What is bad is that these low grade ores can't be extracted later without compromising the mine's structural integrity and so there is less silver to be mined in the future.

Demand for silver is high as this rare metal has so many applications in areas like industry, electronics, solar panels and mirrors and gold is the only real replacement for silver. So this demand factor will contribute to silver's price rising and as people first go to gold and then silver after gold gets to expensive, silver will have to go up further in price to reach a one to nine ratio with gold, which will be much higher than. Silver is ridiculously undervalued and its potential gains make it a much more profitable investment than gold.

Gold and Silver are just in their Cycle

One should know that silver and gold are in their cycle of being the right investment. They have the problem of not being able to generate a cash flow like stocks, bonds and real estate. The reason to go into these metals is to be able to buy more stocks, bonds and real estate in the future.

When to Sell

The decision to sell your holdings of gold and silver can be hard and so you have to use several indicators to decide when to sell. We had gone over the Dow/gold ratio, which can be used in conjunction with the gold/silver ratio, the median price home/gold ratio when to find the right time to sell. If for the Dow/gold ratio for example goes to 1.5 or below, then it could be time to sell. Overall using all the different indicators that have been discussed throughout this chapter and this book in extension will give a more accurate picture on when to sell.

An Aging World Population

Currently the worldwide population is aging and global birth rates are dropping at the same time. This doesn't bare well for the worldwide economy as these demographics can end up being the trigger for an economic depression. Countries like Japan, Germany, America and the US have already a big aging population problem. This is a problem because:

- An aging population puts a greater burden on younger generations to support them and this can cause the welfare system to collapse.
- As more and more people retire and they draw out their superannuation and other retirement funds, which are mostly in the stock market, we will see the global stock markets crash.
- Many retirees and a decreasing world population will mean that the number of houses on sale will increase and the demand for houses decrease causing the housing market to crash too.

The stock market would crash before the housing market will and it can take several decades to occur. Japan for example saw their housing market crash in the 1980's and it hasn't fully recovered yet due to their aging population. So, because of this, investing into stocks and real estate isn't the brightest idea. However when these markets have bottomed and the world population starts increasing again you can then buy houses and stocks at bargain prices.

The Deflation Scenario

When an economy goes into depression they either experience inflation or deflation. The Great Depression for example was a deflationary crash, where the excess credit in the system was wiped out. Now we have mountains of cheap credit in the system and when this credit gets wiped out, we will experience a big deflation. In a deflation the currency supply contracts and the cost of living decreases, but those in debt will be devastated as prices and wages drop while debt remains the same. So, being in debt isn't a good idea for the reason a deflation can likely happen. The governments along with many others don't want deflation as they are also in debt. After this deflation we will probably see high inflation or hyperinflation as the central banks send out their stealth bombers armed with money bombs on carpet bombing missions.

In terms of investing in a deflationary scenario all asset classes will drop in value. So, currency can be a suitable investment...for a while. A deflation can either scare people to lose confidence in the currencies or the fiat currencies will be completely deflated and the central banks might hyper inflated the currencies too. For these reasons you need to have a certain percentage of your portfolio in precious metals.

It might seem like a good idea to wait until the deflation before buying precious metals, but the problem is that both gold and silver will mostly likely be in shortages and therefore unattainable. Like how it was very hard to get your hands on any physical gold or silver during the financial crisis of 2008.

Making Up Your Own Mind

This chapter has gone through various investment options, indicators for finding their value and suggestions on what to buy. However the final decision on what action you take is of your own choice, but what I would advise is to buy physical gold and silver and maybe some other investments and then sell it at the right time to buy real estate and stocks.

Preparation

Now you have all the knowledge to start preparing for a crisis and to position your finances right in order to benefit from one. This last chapter will outline ways to prepare, such as buying emergency supplies and becoming more independent by having your own water supply for instance. One important aspect of being prepared is by learning more and staying updated on economic events and to do this you should go further than just reading this book. Try looking at David Quintieri's and Mike Maloney's Youtube channels and books for starters.

Staying Informed

A solid foundation of knowledge needs maintenance in order for that knowledge to be retrained. Doing further reading and staying informed will not only maintain your knowledge, but help you make informed decisions on things such as when to sell your holdings. As economics has such a big impact on our lives, especially now, it's essential to know these things, because *"Not knowing this stuff can seriously damage your wealth"* as Niall Ferguson simply explains.⁴⁹

Mike Maloney

Mike Maloney is an economist that is famous for his insights and expertise in monetary history and precious metals dealing. He has a book "Guide to Investing in Gold and Silver" that gives an overview of economic and monetary history and explains on how to invest in precious metals. He also has a Youtube channel "Mike Maloney" that brings out occasional videos on current events. This channel also has a series as mentioned previously that does an excellent job at explaining monetary history and economics.

The Money GPS

"The Money GPS: Guiding You Through An Uncertain Economy" is a book by David Quintieri that explains economics, investing and recent economic history. Quintieri also has a Youtube channel that he puts insightful videos on. These are ten minute videos that cover current economic events that might also look at environmental issues and these videos are often excellent and well researched with Quintieri displaying links to the information he discusses.

Other Resources

The following are websites you can visit that offer a variety of information such as unemployment statistics.

Shadow Government Statistics: This site founded and run by John Williams provides more accurate statistics of US inflation, unemployment, GDP and currency supply.

<http://www.shadowstats.com>

National Debt Clocks: Displays the amount of debt and debt as percentage of GDP of countries.

<http://www.nationaldebtclocks.org>

Free the World: Gives information about the economic freedom of countries.

<http://www.freetheworld.com>

Saint Louis Fed: Contains information on US base currency supply.

<https://research.stlouisfed.org>

Money Morning: Posts articles from various economist about the current economic situation. This site provides valuable information on Australia and the World.

<http://www.moneymorning.com.au>

Macrotrends: Provides others graphs on various statistics like the Dow/gold ratio that cover long time spans.

<http://www.macrotrends.net/>

Trading Economics: Has graphs on many different statistics such as currency supplies, price of assets and commodities and exchange rates.

<http://www.tradingeconomics.com/>

Becoming Independent

The more independent you are from the system the better. Take two families, one has all its water and electricity supplied by the state, while the other family has their own water system and electricity supply and then the nation they live in goes into anarchy. Which family will be better off. The latter family will still have their electricity and water, while the former family might see their water and electricity supply be cut off. Therefore being self-sufficient is necessary and it can also improve your health.

Financial Independence

Being financial dependent on the government is simply not a position you want to be in. The more dependent you are the more control they have over you and this goes the same with debt; you don't want to be in debt or as little in debt as possible. With the level of economic unsustainability getting out of debt is vital, but being somewhat in debt for living costs can still be done, it's the bigger amounts of debt that are dangerous.

Being Financial Positioned

After paying back your debts you can then start taking measures such as buying physical gold and silver. Taking our savings out of the bank is advisable and a society in crisis mode will see physical gold and silver being the only acceptable median of exchange, as no one will accept hyper-inflated worthless pieces of paper any more. So having physical gold and silver will allow you to obtain necessities like food when others will have to rely on soup kitchens and hand outs.

Own Water, Food and Electricity

Water, food and electricity are allow important necessities that are normally supplied by the state, but a person can try to have their own independent supply. Having your own water supply in the form of water tanks collecting rain water and electricity from solar panels will secure your own supply to these necessities, which can easily become inaccessible if supplied by the state. Having a personal garden, farm or being on good terms with nearby farmers can secure a steady food supply.

Health Reasons

Having your own water and maybe food can be a real health benefit. City water is known for being less healthy than rain water and processed and GM foods are also known for causing health issues. In a city or town you can use a filter to make sure the water is clean.

Emergency Supplies

Another possible choice is to get emergency supplies. This can be a few months worth of emergency long lasting food that you can eat if other sources run out. Food is a problem in financial turmoil, just look what happened in the Weimar Hyperinflation and what is going on in Greece and in Venezuela now. People are lining up for food and almost all consumer goods have to be rationed. So getting emergency supplies might be worth getting.

Making a Difference

"Every Dollar You spend is a vote you cast for the world you want."

L.N. Smith

David Quintieri in a video discusses which party to vote for in the Canadian elections. He states that both the parties will do the same due to lobbying from businesses and such and in doing so, brings up the above quote, *"Every dollar you spend is a vote you cast for the world you want"*. What you spend your money on will effect the world. He uses the company Monsanto for an example, which is a chemical company that produces GM foods. Quintieri doesn't like Monsanto and he will not buy GM foods to vote against them. If he was buying products made by Monsanto, he would be giving them sales and so he would end up supporting them. Another example is that people that oppose sweetshops and child labour won't buy Nike products. This is one simple way you can make a difference.⁴⁸

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Keynesian
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The Great
Depression